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No. 87-

IN THE

Supreme Court of the United States

OCTOBER TERM, 1987

SEABOARD SURETY COMPANY
and
THE HOME INSURANCE COMPANY
Petitioners,

v.

UNITED STATES OF AMERICA
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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QUESTIONS PRESENTED FOR REVIEW

Whether in disputes involving federal government contracts, the Government can avoid the requirements of the Contract Disputes Act of 1978 and divest the United States Claims Court of jurisdiction by suing a Miller Act performance bond surety directly in federal district court before establishing the liability of the contractor-principal.

Whether the Government can deprive a Government contractor of its rights under the Contract Disputes Act of 1978 and the "Disputes" clause of a federal Government contract by seeking damages directly from the contractor's Miller Act surety rather than seeking such damages from the contractor.

Whether the Government can increase the liability of a Miller Act surety by seeking damages directly from the surety in federal district court rather than seeking such damages from the surety's principal.

PARTIES TO THE PROCEEDING SOUGHT TO BE REVIEWED

This petition seeks review of a decision of the United States Court of Appeals for the Second Circuit. The parties to that appeal were:

Defendant-Appellant

Seaboard Surety Company

and

The Home Insurance Company

Plaintiff-Appellee/Cross Appellant

United States of America

(Department of Agriculture)

RELATED COMPANIES

Seaboard Surety Company

St. Paul Fire and Marine Insurance Company (parent)

The Home Insurance Company

The Home Group, Inc. (parent)
The Hawaiian Insurance and Guaranty Co., Ltd. (affiliate)
Robinson-Conner, Inc. (affiliate)

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OPINIONS BELOW

Review is sought of a decision by the U.S. Court of Appeals for the Second Circuit published as *United States of America v. Seaboard Surety Company and The Home Insurance Company*, Nos. 379, 487, Docket Nos. 86-6145, -6163 (2d Cir. April 27, 1987), pages 2633-2654. The full text of the decision is set out in Appendix A.

STATEMENT OF JURISDICTION

A panel of the U.S. Court of Appeals for the Second Circuit filed the opinion which is the subject of

this petition on April 27, 1987. The case was argued before a three judge panel consisting of Judges Mansfield, Pratt, and Altimari on November 25, 1986. Judge Mansfield died before the opinion was prepared, and the case was decided by Judges Pratt and Altimari pursuant to Second Circuit Rule §0.14.

The U.S. Court of Appeals for the Second Circuit denied a petition for rehearing and a suggestion for rehearing *en banc* on June 11, 1987.

This petition is filed within 90 days of the Second Circuit's denial of rehearing. This Court has jurisdiction pursuant to 28 U.S.C. §1254(1) and §2101(c).

STATUTES INVOLVED

The principal statute involved in this case is the Contract Disputes Act of 1978 ("CDA"), 41 U.S.C. §601, *et seq.*, and the Miller Act, 40 U.S.C. §270, the relevant portions of which are set out in Appendices E and F, respectively.

STATEMENT OF THE CASE

I. The Nature of the Case

This case is one of a series of actions resulting from the default termination of a federal Government construction contract between the Joseph Morton Co., Inc. ("Morton") and the United States Department of Agriculture. This particular action was filed by the United States of America (the "Government") against Seaboard Surety Company and The Home Insurance Company (the "Sureties"), who were co-sureties on a Miller Act bond issued to secure performance of the Morton contract. In this case, the Government sought compensatory damages in excess of the penal

sum of the bond on the ground that the Sureties acted in bad faith. The Sureties raised several defenses based on lack of jurisdiction, on the six-year delay in completing the work, and on numerous changes made in the design of the project following the termination.

II. Related Legal Proceedings (1980-1986)

The default termination of the Morton contract in March 1979 loosed a torrent of litigation. In March 1980, Morton filed under Chapter 11 for voluntary bankruptcy in the Eastern District of New York.[1] While that matter was pending, proceedings were started in the Eastern District of New York which resulted in the conviction of Morton on April 24, 1981 for violations of the False Statement Act, 18 U.S.C. §1001. *United States v. Joseph Morton Co.*, Docket No. CR-80-00413 (E.D.N.Y., April 24, 1981), *aff'd*, Nos. 81-1174/1233 (2d Cir. Jan. 11, 1982).

On March 1, 1982, Morton filed a complaint in the United States Court of Claims (now, the United States Claims Court) seeking "...a determination converting the default termination to one for the convenience of the Government." In effect, Morton was seeking a determination that the termination for default was improper and that the Government, rather than Morton, was in breach of contract. *See* 41 C.F.R. §1-18.800, *et seq.* (1978) On the same day, the Government filed this action in the Eastern District of New York against the Sureties seeking to recover under the bond for Morton's alleged breaches of the contract.

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[1] In April 1983, the bankruptcy court refused to discharge Morton, and the petition was dismissed.

In May 1982, the Government filed an amended answer in the Claims Court, adding as an affirmative defense "...a special plea in fraud for a judgment of forfeiture to be entered pursuant to 28 U.S.C. §2514." This was followed in August 1982, by the Government's motion for summary judgment against Morton on the grounds of Morton's criminal conviction in the Eastern District.

A year later, in May 1983, the Government moved the Claims Court for leave to file a second amended complaint with counterclaims. The proposed counterclaims, in substance, made the same allegations of breach of contract and amount of damages against Morton as are alleged by the Government against the Sureties in this action.

In July 1983, the Claims Court ruled that the subsequent criminal conviction of Morton justified the termination for default, even though the Government was unaware of and had not asserted the fraudulent conduct as the basis for the default termination. *Joseph Morton v. United States*, 3 Cl.Ct. 120 (1983). (App. 43a). However, on November 18, 1983, the Claims Court held that if Morton elected to proceed under the Contract Disputes Act with respect to the Government's proposed counterclaim, it was a jurisdictional prerequisite that the counterclaim be "the subject of a decision by the contracting officer" as required by 41 U.S.C. §605(a). *Joseph Morton v. United States*, 3 Cl.Ct. 780 (1983). Morton appealed the decision on the propriety of the default termination to the Federal Circuit, and the Government filed a cross appeal on the issue of its counterclaims. In March 1985, the Federal Circuit rendered its decision affirming both of the rulings by the Claims

Court. *Joseph Morton Co., Inc. v. United States*, 757 F.2d 1273 (Fed.Cir. 1985). (App. 25a).

III. The Contracting Officer's Final Decision (1986)

On January 6, 1986, as the instant case was ready to go to trial, the contracting officer issued his final decision on the issue of damages. His decision charged Morton and the Sureties, jointly and severally, with damages in the net amount of $14,495,682. (App. 66a). The decision also apprised Morton and the Sureties of their right under the CDA to appeal the decision to the Claims Court which they did on January 22, 1986. *Joseph Morton Co., Inc. et al v. United States*, Docket No. 48-86C (Cl.Ct., filed January 22, 1986). As of the date of this petition, that action is still pending.

IV. Course Of Proceedings in This Case

The Government's complaint in this action alleged jurisdiction on the basis of 28 U.S.C. §1345. During the pretrial stage of the instant case, both parties filed motions for summary judgment. In their motion, the Sureties argued that (a) the bond was a contract within the meaning of the CDA, and (b) a contracting officer's final decision on the question of damages was a condition precedent to any action in any forum against either Morton or the Sureties. In its motion, the Government argued that the Sureties' liability had been established by virtue of the Federal Circuit decision upholding the propriety of the default termination.

In denying both motions, the trial court held that the Sureties had provided a performance bond and not a fidelity bond. Therefore, the Federal Circuit decision upholding the termination on the basis of

Morton's criminal conviction did not preclude the Sureties from raising a defense based on Morton's performance. With regard to the question of jurisdiction, the court held that the CDA did not apply because the Sureties were not parties to Morton's construction contract. *United States v. Seaboard*, 622 F.Supp. 882 (1985).

The Sureties then asked the trial court to certify the question pursuant to 28 U.S.C. §1292. When the court refused to do so, the Sureties filed a petition for mandamus with the Second Circuit. The petition was denied, without opinion, and the case proceeded to trial before a jury on May 7, 1986. *In re Seaboard Surety*, No. 86-3007 (2d Cir. 1986).

At the conclusion of a two week trial, the jury awarded $10,631,626 in compensatory damages against the Sureties. In responding to special interrogatories, the jury indicated that the Sureties had acted in bad faith. The trial court, acting without the jury, awarded an additional $6,755,321.73 as prejudgment interest. Judgment in the total amount of $17,386,647.73 was entered on June 30, 1986.

The Sureties appealed from that judgment to the U.S. Court of Appeals for the Second Circuit. The appeal raised four issues, *viz.*, (1) the subject matter jurisdiction of the district court, (2) the admissibility of evidence of bad faith, (3) the exclusion of evidence related to post-termination changes, and (4) the amount and timing of prejudgment interest.

In its decision of April 27, 1987, which is the subject of this petition, the Second Circuit held (1) that the Government could sue a Miller Act surety directly in federal district court without waiting for an ad-

judication of the principal's liability in the Claims Court, (2) that submitting the issue of bad faith to the jury was error, but harmless error, and (3) that prejudgment interest had been improperly calculated by the trial court. The decision did not address the issue of the excluded evidence on post-termination changes. The Second Court remanded the case for a recalculation of prejudgment interest.

In its petition for rehearing and suggestion for rehearing *en banc*, the Sureties asked the Second Circuit: (1) to reconsider the effect of the errors relating to bad faith and (2) to render an opinion on the exclusion of the evidence on post-termination changes. Both the petition and the suggestion were denied without opinion on June 11, 1987. (App. 23a).

REASONS FOR ALLOWING THE WRIT

I. Introduction

The practical effects of the Second Circuit's decision are: (1) to make a surety who is acting as a guarantor primarily liable for the default of its principal, and (2) to make the surety's liability greater than that of its principal.

To the extent that these results allow the Government, at its sole discretion, to circumvent the Congressionally mandated jurisdiction of the U.S. Claims Court and, in the process, to strip the contractor-principal of certain statutory and contractual rights, the decision erroneously answers an important question of federal law.

To the extent that the decision makes the Sureties' liability primary and measures that liability by some standard other than the liability of the principal, the

decision is in conflict with the traditional concepts of suretyship law as announced by this Court and by other circuits.

II. The Second Circuit Decision Involves Important Questions of Federal Law

The Second Circuit upheld the contention that the Government could proceed directly in district court against the Sureties even though the identical claim was then pending against both the Sureties and the contractor-principal in the Claims Court. In doing so, the Second Circuit acknowledged that a Miller Act surety's liability is derivative and that under the provisions of the CDA, the Claims Court has exclusive jurisdiction of the Government's claims against the contractor-principal. (App. 10a). Nevertheless, the Court concluded that the Sureties' liability is "distinct" from that of the principal and therefore not subject to the exclusive jurisdiction of the Claims Court. (App. 11a).

The exclusive jurisdiction of the Claims Court over Government contract matters was established by Congress in the Contract Disputes Act of 1978 41 U.S.C. §601, *et seq.* The CDA provides a comprehensive administrative and judicial procedure for the resolution of all claims, *by or against the Government*, arising out of a federal Government contract. 41 U.S.C. §605(a). (App. 55a). By making a Miller Act surety primarily and independently liable for the default of its principal, the Second Circuit has eviscerated the jurisdictional mandate of the CDA.

In enacting the CDA, Congress had two main purposes. First, was to provide a fair and quick means of resolving Government contract disputes. Second,

was to eliminate U.S. district court jurisdiction of government contract claims by making the Claims Court the exclusive forum for such claims. The Claims Court was given exclusive jurisdiction because of the district courts' limited expertise in government contract claims and because the Claims Court has historically been the court of greatest expertise in such claims. m Senate Report No. 95-118, *1978 U.S. Code Senate Code Cong. & Admin. News*, p. 5235, 5244.

The decision of the Second Circuit frustrates both purposes. This can be illustrated by considering the effect of the decision on the pending Claims Court action. As explained in the Statement of the Case, the Claims Court case is the result of the Federal Circuit's decision in *Joseph Morton Co. v. United States*, 757 F.2d 1273 (Fed.Cir. 1985), (App. 25a), which held that the Sureties' principal was entitled to have the quantum portion of the Government's claim for damages processed under the provisions of the CDA.[2]

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[2] In that case, the Federal Circuit rejected the Government's argument that the district court was the exclusive forum for the Government's damage claims against Morton. *Morton*, 757 F.2d at 1279 (Fed.Cir. 1985). (App. 37a). Instead, the Federal Circuit ruled that the Government's quantum claims were subject to the CDA, and that, "For the foregoing reasons, we hold that the Government's counterclaims must first be raised before a C[ontracting] O[fficer]." *Morton*, 757 F.2d at 1281. (App. 42a). The ruling by the Federal Circuit is the law of the case, and that ruling was obviously not on appeal to the Second Circuit. Yet the Government, by its own admission, sought nothing less than reversal of the Federal Circuit's decision. ("The Federal Circuit's holding should be rejected," Government's Brief to the Second Circuit, p. 30, fn. 12). Such a reversal would be the practical result of endorsing the district court's jurisdiction of

If, as the Government has argued,[3] the Sureties and the contractor-principal are now collaterally estopped from pursuing the Claims Court action, then the contractor-principal has been denied a right given him by the law of the case in *Morton*, by the "Disputes" clause of his contract (App. 64a), and by the express terms of the CDA. In addition, by allowing the Government to sue the Sureties in district court without waiting for an adjudication of the contractor-principal's rights under its contract and the CDA, the Second Circuit enables the Government to avoid the Congressionally mandated jurisdiction of the Claims Court.

If, on the other hand, the Claims Court action is not estopped, then it can proceed to its own decision which, at least on the question of prejudgment interest, will be different from that reached by the Second Circuit.[4] To the extent that the Claims Court reaches a different result, it means that the Sureties' liability is not derivative, but rests on some independent basis as yet unarticulated by the Second Circuit or any other court. Such a result is in direct conflict with the general principles of suretyship.[5]

Neither of these outcomes was intended by Congress when it passed the CDA. It is clearly within Congress' powers to establish an exclusive federal forum to adjudicate issues of federal law in a particular area that Congress has the authority to regulate

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this case and allowing the Government to establish a new remedy by pursuing this collateral action against the Sureties.

[3] By motion filed with the Claims Court.

[4] See Section III(B) below.

[5] See Section III(A) below.

under the Constitution. The determination of Congressional intent and of the boundaries of a jurisdictional enactment is a question of federal law. *International Longshoremen's Assn. v. Davis*, 476 U.S. ___ (1986); 90 L.Ed.2d 389, 398.

Similarly, the decision of the Second Circuit casts serious doubt the obligations of sureties under Miller Act performance bonds, bonds which cover billions of dollars of federal construction work. The rights and obligations of a Miller Act surety are also important questions of federal law. *United States v. Seaboard Surety Co.*, 339 F.2d 1, 3 (2d Cir. 1964); *American Auto Insurance Co. v. United States*, 269 F.2d 406, 408 (1st Cir. 1959).

These issues, *viz.*, conflicting jurisdiction within the federal judicial system and the liability of a Miller Act surety, involve two statutes that lie at the heart of the federal procurement process (the CDA and the Miller Act). If there is to be new law in this area, it should come only after this Court has reviewed the matter.

III. The Decision of the Second Circuit Conflicts with the Decisions of this Court and of Other Circuits

A. Nature of the Sureties' Liability

By allowing the Government to proceed directly against the Sureties without waiting for an adjudication of the principal's liability, the decision of the Second Circuit makes the Sureties primarily liable for the default. This result conflicts with the decision of this Court and of other circuits.

The term "surety" is used to describe two legally different types of suretyship obligations. In one, the surety acts as a "joint promisor" who joins the orig-

inal contract with the principal and may be sued as an unconditional promisor along with the principal. In the second, the surety acts merely as a "guarantor" whose liability arises from an independent agreement which is expressly conditioned upon the default by the principal. When sued, a surety acting as a guarantor has at least one defense that a surety acting as a joint promisor does not have, *viz.*, that the liability of the principal has not yet been established. *Rhode Island Hospital Trust National Bank v. The Ohio Casualty Insurance Company*, 789 F.2d 74, 78 (1st Cir. 1986); *United States v. Griffin*, 707 F.2d 1477, 1480 (D.C. Cir. 1983); *United States v. Frisk*, 675 F.2d 1079, 1082 (9th Cir. 1982). Thus, a surety's obligation is more a guaranty of collection, with conditions precedent to liability of the surety, than a guaranty of payment. *United States v. Westchester Fire Insurance Co.*, 478 F.2d 133, 137 (2d Cir. 1973). This is consistent with the observation of this Court that suretyship, including Miller Act suretyship, is not insurance. *Pearlman v. Reliance Ins. Co.*, 371 U.S. 132, 140, fn 19 (1962).[6] From the general concept of a surety as guarantor, there flow two well-established tenets of suretyship law. First is the concept that a

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[6] It is clear from both the terms of the bond itself and from the Government's procurement regulations that a Miller Act surety is a "guarantor" and not a joint promisor. The obligation of the surety set out in the bond is expressly conditioned upon the non-performance of the principal. (App. 62a). The status of a Miller Act surety as a guarantor is implicit in the judicial history of the Miller Act. Despite the extensive briefing that has surrounded this case, the Sureties have not found, and the Government has never cited, a single case in which a Miller Act surety was sued by the Government before the liability of the principal had been established.

surety's liability is strictly derivative; the surety is liable if, and only if, its principal is liable. A performance bond surety is not in the same position as a joint tort feasor or a joint venturer; the surety's liability is secondary to that of its principal. *Coleman Capital Corporation v. Travelers Indemnity Co.*, 443 F.2d 47, 52 (2d Cir. 1971); *Painters Local #171 v. Williams & Kelly*, 605 F.2d 535, 539 (10th Cir. 1979); *Continental Bank & Trust Co. v. American Bonding Co.*, 605 F.2d 1049 (8th Cir. 1979). The Government, like any other obligee, must prove that the principal is liable before it can proceed against the surety. Even the trial court recognized this fact when it ruled that the only issue before it was the contractor-principal's performance. *United States v. Seaboard*, 622 F.Supp. 882, 885 (E.D.N.Y. 1985).

Second is the concept that a surety's rights and obligations must be construed in light of the underlying contract between the principal and the obligee. The Claims Court has said that a Miller Act surety is as much a party to the underlying contract as the contractor. *Balboa Insurance Company v. United States*, 775 F.2d 1158, 1160 (Fed.Cir. 1985). In so holding, the Claims Court relied in part on this Court's decision in *Martin v. National Surety Co.*, 300 U.S. 588, 598 (1937) which indicated that the terms of the bond and the contract are to be read together.

In *Pearlman v. Reliance Ins. Co.*, 371 U.S. 132, 140 (1962), this Court made it clear that nothing in the Miller Act was intended to change the traditional concepts of suretyship law. This Court should review this matter to preserve the principles of suretyship law that are "...so deeply imbedded in our commercial

practices, our economy, and our law." *Pearlman*, 371 U.S. at 140.

B. Extent of the Sureties' Liability

Under federal Government contract law and under the Federal Acquisition Regulations ("FAR's"), 48 C.F.R. §1, *et seq.*, the contractor-principal's liability, and thus the Sureties' liability, would be less in the Claims Court than in the district court. The practical effect of the Second Circuit decision is to make the Sureties liable for a greater amount than its principal would be liable for in the Claims Court. This result is apparent from the Second Circuit's decision on prejudgment interest.[7] In the case of a default under a federal Government contract, the contractor's liability for prejudgment interest is controlled by the FAR's, both as to the rate of interest and as to the period of interest. Such interest runs from the date of the demand for payment by the Government, following completion of the project and final payment to the completion contractor, at the so-called "renegotiation rate" as specified by the Secretary of the Treasury

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[7] Arguably, the liability of the contractor-principal and the Sureties for damages would also be less in the Claims Court. Under the decisions of this Court and the Claims Court, the Government's claim for damages following a default must be reduced by the cost on any post-default changes made in the project for the Government's convenience. Depending on the scope of such changes, these changes may be a complete defense to the Government's claim for damages. *United States v. California Bridge*, 245 U.S. 337 (1917); *Marley v. United States*, 423 F.2d 324 (Ct.Cl. 1970) *United States v. McMullen*, 222 U.S. 460, 471 (1911). In this case, the district court excluded the Sureties' evidence on post-default changes. Although this issue was raised on appeal, the Second Circuit failed to address it, and the Sureties' petition for rehearing on this point was denied.

in 50 U.S.C. App. 1215(b)(2). 48 C.F.R. §32.610(b)(2). Under the facts of this case, the contractor-principal would be liable for such interest from January 6, 1986 (the date of the Contracting Officer's Final Decision) at the rate of 9.75%, the renegotiation rate in effect at the time.

Cases involving Federal government contracts are in complete accord. *Universal Transistor Products Corp. v. United States*, No. 61-C-654 (E.D.N.Y. 1965) reported at 10 CCF ¶72,971. (Interest is to be calculated from the date of actual payment to the completion contractor). *Western Filter Company*, ASBCA Nos. 16728, 16880, 72-2 BCA ¶9662; *Solar Laboratories, Inc.*, ABSCA No. 19957, 76-2 BCA ¶12,115. (Prejudgment interest cannot be charged for any period earlier than the date of actual payment of the completion costs by the Government). *Do Well Manufacturing Co., Inc.*, ASBCA No. 18285, 74-1 BCA ¶10,497. (Where there has been both an actual final payment to the completion contractor and a formal demand for payment against the defaulting contractor, interest is charged from whichever event occurred later).

In this case, the trial court, acting without the jury, awarded the Government $6,755,321.73 in prejudgment interest on the $10,631,326 damages awarded by the jury. Although final payment to the completion contractors was not made until 1986, the interest covered the period from May 30, 1980 to May 21, 1986, the date of the verdict. The court assessed interest at the "...discount rate available as of May 30 of each year for which the defendants were in breach ...," a rate that ranged from 6.5% to 14% *per annum*. The court specifically found "...that no statute or regu-

lation controls the case at bar and, therefore, the imposition of prejudgment interest lies within the Court's discretion."

On appeal, the Second Circuit held that the provisions of the FAR's did not apply to a Miller Act surety and that therefore the imposition of prejudgment interest was a matter for the discretion of the court. They went on to hold that there had been an abuse of that discretion and remanded the case for a recalculation of interest using a starting date in 1983. (App. 21a). The result is to charge the Sureties with prejudgment interest for a longer period and at a different rate than the contractor-principal is liable for in the Claims Court.

The Second Circuit decision on the prejudgment interest conflicts with the decisions of this Court and of other circuits in four distinct ways. First, it makes the Sureties liability different from, and greater than, that of its principal. This conflicts with the general law of suretyship set out above.

Second, it denies the Sureties any rights under the terms of the underlying construction contract. This also conflicts with the general notion of suretyship law as well as the holding of the Federal Circuit in *Balboa*, 775 F.2d at 1160 that the surety is a party to the underlying contract.

Third, it conflicts with this Court's holding in *Royal Indemnity Company v. United States*, 313 U.S. 289, 295 (1941), that interest is to be assessed against a Miller Act surety at the rate prescribed by statute.

Fourth, it conflicts with this Court's policy against forum shopping. The decision on the prejudgment interest issue makes the Sureties' liability dependent on

the forum in which the Government chooses to act. If the Government pursued the normal course of remedies set out in the contract, the FAR's, and the CDA, the Sureties would be liable for the same interest as the principal. But if the Government pursues the Sureties without waiting for an adjudication of the contractor liability, then the issue of interest is left up to the discretion of the district court which may, as it did in this case, assess a much higher amount than would be available in the Claims Court.

The situation is similar to that addressed by this Court in diversity cases where the Court adopted the "outcome-determinative" test. *Guaranty Trust Co. v. York*, 326 U.S. 99, *reh'g denied* 326 U.S. 806 (1945) The rationale for that test was to avoid forum shopping for a favorable result as between a state court and a federal court sitting in the same state. *See, Commissioner v. Estate of Bosh*, 387 U.S. 456 (1967). This Court should review this matter to prevent the same type of forum shopping within the federal judicial system.

IV. Summary

There are four compelling reasons why the writ should be allowed in this particular case. First, despite the fact that both issues (jurisdiction and extent of surety's liability) involve important questions of federal contract law and procedure, the case was decided completely outside the normal administrative and judicial procedures that have been statutorily established for the resolution of Government contract matters.

Second, the decision acknowledges that it involves a "close question." (App. 10a).

Third, as a result of the unfortunate death of Judge Mansfield, the case was decided by only two judges.

Fourth, despite its far reaching consequences, the Second Circuit decision provides no guidelines as to when a surety's liability should be measured by something other than that of its principal or when the Government may pursue a Miller Act surety without first making a claim against the principal. Without such guidelines, the resolution of disputes under federal contracts and the liability of sureties in general will be thrown into confusion, if not outright chaos.

The creation of new law, without guidelines, which involves a close question of federal law affecting billions of dollars of contracts and surety bonds is obviously an appropriate matter for review by this Court.

CONCLUSION

For the foregoing reasons, this petition for a writ of certiorari should be granted.

Respectfully submitted,

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APPENDIX

APPENDIX A

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

Nos. 379, 487—August Term, 1986

(Argued: November 25, 1986 Decided: April 27, 1987)

Docket Nos. 86-6145, -6163

UNITED STATES OF AMERICA,
Plaintiff-Appellee, Cross-Appellant,

— against —

SEABOARD SURETY COMPANY and THE HOME INSURANCE COMPANY,
Defendants-Appellants, Cross-Appellees.

SEABOARD SURETY COMPANY and THE HOME INSURANCE COMPANY,
Defendants-Third-Party-Plaintiffs,

— against —

JOSEPH MORTON COMPANY, INC., JOSEPH J. BATTAGLIA, and THE PERKINS & WILL PARTNERSHIP,
Third-Party-Defendants.

Before:

MANSFIELD,* PRATT, and ALTIMARI,
Circuit Judges.

Appeal from a judgment of the United States District Court for the Eastern District of New York, Leonard D. Wexler, *Judge,* entered after a jury trial, holding defendants liable for damages and interest totaling $17,386,647.73 based on a Miller Act performance bond issued by defendants.

Affirmed in part, reversed in part, and remanded.

PETER R. GINSBERG, Assistant U.S. Attorney for the Eastern District of New York, Brooklyn, NY (Andrew J. Maloney, U.S. Attorney for the Eastern District of New York, Robert L. Begleiter and Thomas B. Roberts, Assistant United States Attorneys, of Counsel), *for Plaintiff-Appellee, Cross-Appellant.*

WILLIAM W. THOMPSON, Jr., Alexandria, VA, (Michael L. Thomas, Hudson, Creyke, Koehler & Tacke, of Counsel), *for Defendants-Appellants, Cross-Appellees.*

*Judge Mansfield participated in the oral argument of this appeal, but died before this opinion was prepared. The case is therefore being decided by Judges Pratt and Altimari pursuant to Second Circuit Rule § 0.14.

PRATT, *Circuit Judge*:

This appeal arises from the decade-long effort to expand the federal government's facilities for research into animal diseases at Plum Island, a small, federally owned island just off the eastern tip of Long Island's north fork. The appellants, Seaboard Surety Co. and The Home Insurance Co. ("the sureties"), provided a bond pursuant to the Miller Act, 40 U.S.C. § 270a *et seq.*, guaranteeing the performance of The Joseph Morton Company ("Morton"), which was the general construction contractor on that project. The sureties were held liable based on Morton's breach of its contract with the United States for the Plum Island expansion. On appeal they challenge the jurisdiction of the district court, the admission of certain evidence of bad faith on the part of the sureties, and the calculation of the prejudgment interest awarded by the trial court.

BACKGROUND

In the early 1970s, the Department of Agriculture ("DOA"), which operates the government's Plum Island Animal Disease Center, began making plans to expand that facility. The first step was to develop criteria to be used in the design and eventual construction of the new buildings. Central to those criteria, and to subsequent events, was the goal of insuring that Plum Island be operated as a "bio-containment" facility; that is, that the extremely dangerous strains of animal diseases being studied not become hazardous to the surrounding environment. It was thus necessary to design air-tight buildings, using sophisticated ventilation and filters.

Once the criteria had been established, the government in 1973 hiredPerkins & Will, an architectural and engi-

neering firm, to prepare plans and specifications for the proposed facilities which would meet the design criteria. The Perkins & Will designs were accepted by the government and became the basis for an invitation for bids issued by the DOA on August 4, 1976. The low bid was submitted by Morton, which on September 24, 1976, was awarded the contract for $10,049,000, subsequently increased to $10,689,000.

Construction on the project began in March 1977, and was almost immediately beset by problems. On March 23, 1977, the government issued the first in what quickly became a series of "cure notices", which put a contractor on notice that some aspect of its performance is unsatisfactory and which require certain specified corrective action to be taken by a fixed date.

Throughout the time Morton was on the job, there were various problems that culminated on February 14, 1979, with the issuance of a final, 55-page cure notice, detailing many inadequacies in Morton's work, including defective construction, poor maintenance, and undue delays. Unsatisfied with Morton's response, the government terminated Morton for default on March 1, 1979.

At the time of termination, the government had approved payment to Morton, on an as-completed basis, of $9,048,060, of which it had actually paid $8,231,260. The sureties claim that approximately 85% of the total project was completed, since the amount approved for payment represented 85% of the total contract price. As the government notes, however, none of the work on such a project is officially accepted or approved until the entire project is complete.

In any event, the government next turned to the sureties and requested that they step in and complete the project.

After offering to complete the project using Morton, an option the government understandably rejected, the sureties, in letters dated April 13, 1979 and May 2, 1979, declined to complete. As we will discuss more fully *infra*, a surety has the option, when its principal is default-terminated, of either coming in and completing the project or paying the government its damages, essentially the cost of completion. *Trinity Universal Insurance Company v. United States*, 382 F.2d 317, 321 (5th Cir. 1967), *cert. denied*, 390 U.S. 906 (1968). A surety may, of course, also challenge the propriety of the default termination, thereby, in effect, denying liability on the bond.

This latter course was followed by the sureties in this case. On May 30, 1980, Seaboard sent to Mr. Calvin Persinger, the government's contracting officer on the project, a letter stating, "Seaboard Surety Company . . . shares the position of its principal . . . that the default determination was unwarranted and that the contract was not breached by Morton, but by the Government. Accordingly, Seaboard denies any liability under its performance bond." Apparently, Seaboard's denial of liability spoke for its co-surety, The Home Insurance Co., and there is no issue raised as to any difference in the positions of the two sureties for purposes of this appeal.

After the sureties declined either to complete the project or pay the cost of completion, the government hired Lasker-Goldman Corporation, a joint venture of Lasker-Goldman Company and Goldman Associates, as "construction manager" to oversee the anticipated completion and assess the cost and magnitude of completing the work. As a result of Lasker-Goldman's assessment and a shortfall in funds available for completion of the project, it was eventually decided that two of the buildings

covered by the original contract, a diagnostic research laboratory (DRL) and a vaccine research laboratory (VRL), would not be completed.

In December 1980, congress appropriated an additional $10,100,000 for completion of the project, and by 1985, it had been finished, except for the VRL and DRL. The cost of completion was almost as high as the initial cost of the project, despite the fact that 85% of the original appropriation had been paid to Morton, and despite the fact that two of the five buildings planned were never completed. The government attributes the high cost of completion to inflation, poor work by Morton that had to be corrected if the facility was adequately to contain the viruses being studied, and deterioration of the material left on the site, where it sat, apparently unattended, from March 1979, when Morton was terminated, to sometime in 1980, when Lasker-Goldman took over. The sureties claim that Lasker-Goldman was vastly overpaid (over $4,600,000) for its role as construction manager. In any case, the DOA ultimately spent in the neighborhood of $20 million to build 60 percent of a project initially budgeted at $10,689,000.

As might be expected, these events gave rise to multiple legal proceedings. In March 1980 Morton filed for bankruptcy under Chapter 11, a petition that was dismissed in April 1983 when the bankruptcy court refused to discharge Morton. In 1980 Morton, its principal Joseph J. Battaglia, and a Morton employee were indicted in connection with the submission of fraudulent documents to the DOA as part of a change order Morton submitted on the Plum Island project. In April 1981 they were convicted of conspiracy to defraud the United States, in violation of 18 U.S.C. § 371, making false statements in the

change order in violation of 18 U.S.C. § 1001, and obstructing justice, 18 U.S.C. § 1503. These convictions were upheld on appeal. *United States v. Joseph Morton Company, et al.*, No. CR-80-413 (E.D.N.Y. April 24, 1981), *aff'd.* Nos. 81-1174, -1233 (2d Cir. Jan. 11, 1982).

Morton took the offensive on March 1, 1982, filing a complaint in the court of claims (now the claims court), seeking determinations that it had not breached its contract with the United States and that the termination was one "for the convenience of the government." On the same day, the government filed the instant suit against the sureties, seeking to enforce their obligations based on Morton's breach.

In July 1983, while proceedings in the instant suit were stayed, the claims court ruled that the criminal conviction of Morton, even though it came after the termination, justified the government's conduct as a default termination. *Joseph Morton Co. v. United States,* 3 Cl.Ct. 120 (1983). This holding was affirmed by the federal circuit, *Joseph Morton Company, Inc. v. United States,* 757 F.2d 1273 (Fed. Cir. 1985). Neither the claims court nor the federal circuit reached the issue of whether termination was justified based on Morton's poor performance. *Id.* at 1275.

Following the resolution of Morton's claims court action, proceedings went forward in the instant case. After extensive discovery, a jury trial began on May 7, 1986. The major focus of the case was Morton's performance from 1977 to 1979, with the government seeking to show that Morton had flagrantly breached the contract, doing poor work, doing even that late, failing to pay subcontractors, and misleading the government about the work it had done. In addition, the government sought to

show bad faith on the part of the sureties in performing their obligations.

For their part, the sureties sought to establish that while Morton's work was far from perfect, termination due to deficient performance had not been justified. They also attempted to show that the original Perkins & Will design had been fundamentally flawed, rendering performance by Morton (in constructing a functioning bio-containment facility) impossible, and that the completion costs incurred by the government were unreasonable.

After two weeks of trial, the jury returned a verdict for the government of $10,631,326. To this sum, the district judge added $6,755,321.73 in prejudgment interest, calculated from May 30, 1980, the date Seaboard sent Mr. Persinger the letter denying liability under the bond, and entered judgment for $17,386,647.73. The sureties appeal.

DISCUSSION

A. *Jurisdiction of the District Court.*

The first contention raised by the sureties is that the district court lacked subject matter jurisdiction because claims against a surety are limited by the Contract Disputes Act ("CDA"), 41 U.S.C. § 601 *et seq.*, to the claims court. This argument takes two forms. First, the sureties urge that a surety is a "contractor" within the meaning of the CDA, and thus that the act, by its terms, is applicable to a surety's performance bond. Second, they argue that even if a surety is not a "contractor", the government must press its claim against the sureties in the claims court, because a surety's liability is wholly derivative from its principal's liability, and Morton, the principal, unques-

tionably was the CDA contractor. These arguments are unconvincing.

1. *Applicability of the CDA to a Miller Act Surety.*

We have little difficulty rejecting the first of the sureties' jurisdictional arguments, for it is clear from the language of the CDA and from its legislative history that a surety is not a "contractor" for CDA purposes.

Section 3 of the CDA, 41 U.S.C. § 602, defines the contracts covered by the act. They include contracts for:

> (1) the procurement of property, other than real property in being;
>
> (2) the procurement of services;
>
> (3) the procurement of construction, alteration, repair or maintenance of real property; or,
>
> (4) the disposal of personal property.

A Miller Act performance bond fits none of these categories. The only one that arguably might include a surety is (2), a contract for the procurement of "services." But even if the surety agreement could be considered a contract to procure "services", it is not a contract to which the government is a party. The bond, itself, was signed by the sureties and Morton; the government's rights are as a third-party beneficiary, not as a party. It is true that the Miller Act required Morton to obtain the performance bond, 40 U.S.C. § 270(a)(1), but that fact alone does not make the government a party to the bond. Since the CDA requires that the "contract" sued upon be a government contract, *see* 41 U.S.C. §§ 601(4), 602(a), we conclude that it does not apply to a bond issued by a surety to a contractor. *See also Universal Surety Company v. United States,*

10 Cl.Ct. 794, 800 (1986) (surety is "not a 'contractor' under CDA").

Nothing in the legislative history alters this conclusion. The stated purpose of the CDA was to make uniform the system of dispute resolution governing federal contracts, a system that varied from agency to agency and from contract to contract. Congress felt that this system discouraged businesses from bidding on government contracts, and that its inefficiency almost certainly increased the cost of government projects. S. Rep. No. 95-1118, 95th Cong., 2d Sess., *reprinted in* 1978 U.S. Code Cong. & Ad. News 5235, 5236-38. Nowhere are sureties or the Miller Act mentioned, and the goals of encouraging bids on contracts and lowering the cost of resolving disputes surrounding government contracts bear little relation to the type of performance bonds that are issued for all large-scale government construction projects. Congress simply had an entirely different set of problems in mind when it passed the CDA, and we see no reason to judicially transform sureties into "contractors" where congress has not done so.

2. *"Derivative Liability" of a Surety.*

A closer question is presented by the sureties' argument that the government should be forced to proceed in the claims court because any liability on the part of the sureties is derivative from Morton's liability and Morton is undeniably a "contractor" under the CDA. Many of the premises that support the argument, looked at in isolation, are valid. Taken together, however, these premises do not lead to the conclusion urged by the sureties.

It is certainly correct that Morton was a "contractor" within the meaning of the CDA. It is also true that a sure-

ty's liability is derivative from its principal's liability. *Coleman Capital Corp. v. Travelers Indemnity Co.*, 443 F.2d 47, 52 (2d Cir. 1971); *Atterbury v. Carpenter*, 321 F.2d 921, 923-24 (9th Cir. 1963).

It does not follow, however, that the derivative nature of a surety's liability places it in its principal's shoes for purposes of vesting exclusive jurisdiction in the claims court. The sureties' liability is not the same as Morton's; it is merely secondary to Morton's. For example, it would easily be possible for Morton to be in breach in a manner that would not leave the sureties liable. Indeed, the federal circuit found Morton in breach based soley on the fraud conviction, *see Morton*, 757 F.2d at 1279, forcing the government at the trial below to show a performance-based breach to establish the sureties' liability.

Since the liability of a surety is distinct from that of its principal, there is no compelling reason to conclude that a claim by the government against a surety must be tried in the claims court simply because claims against the principal must be heard there under the terms of the CDA.

The sureties argue further that any trial of their liability will necessarily focus primarily on the performance of a contractor, as did the trial below. They contend that congress intended the adjudication of such issues to be centralized in a single forum, which would soon develop special expertise in the handling of government contracts cases.

While there is some support in the legislative history for the notion that congress wished to consolidate cases involving claims against and by government contractors, the underlying purpose served by the legislation was to protect contractors, not by creating a court of special com-

petence, but by standardizing the procedures to be followed when contractors and the government have a dispute. The principal rationale for vesting jurisdiction in the claims court thus vanishes where the claim is against a surety rather than a contractor.

Moreover, while the issues in cases like the instant suit will center on the performance of the contractor, there is no reason to believe that the district courts are not fully capable of trying such claims. When it divested the district courts of jurisdiction over cases involving contractors, congress was concerned not with the competence of the district courts in trying such cases, but rather with improving the efficiency of the system as it actually affected contractors. We have every confidence that the district courts can handle even the complexities of government contract and suretyship law, as they have consistently done in the past. *See, e.g., United States v. Seaboard Surety Co.,* 339 F.2d 1 (2d Cir. 1964); *United States v. Glens Falls Ins. Co.,* 546 F. Supp. 643 (N.D.N.Y. 1982); *United States v. Warren Corp.,* 624 F. Supp. 1163 (D. Mass.) *vacated,* 805 F.2d 449 (1st Cir. 1986).

In short, the CDA vests jurisdiction in the claims court over claims arising from government contracts when such claims involve, as parties, the contractors themselves. The goal was to protect contractors and make more smooth the process for resolving their disputes with the government. However, since sureties are not contractors under the CDA, and since liability on the part of a surety is distinct from that of its contractor, we conclude that the district court properly exercised jurisdiction in this case.

B. *Admissibility of Evidence of the Sureties' "Bad Faith".*

The sureties next argue that it was reversible error for the district court to admit evidence of "bad faith" on their

part in denying liability under the bond and in simultaneously alleging that the government, rather than Morton, had breached the construction contract. While we agree that to admit such evidence was erroneous, we conclude that the error here did not "affect the substantial rights" of the sureties. We are therefore directed by Fed. R. Civ. P. 61 to disregard the error.

1. *Evidence of Bad Faith.*

Central to the government's claim of bad faith was its contention that the sureties knew at the time they denied liability under the performance bond that there was no basis for the claim that Morton had not breached the construction contract. The government sought to show such knowledge in three ways.

First, the government elicited testimony that the sureties knew, prior to Morton's termination, that Morton's performance had been extremely poor. For example, Mr. Calvin Persinger, one of the DOA's contracting officers on the Plum Island project, testified that the sureties had been sent copies of the various cure notices that the government had served on Morton. He also testified that the sureties were made aware of the problems that the subcontractors were having with Morton.

Second, the government introduced evidence that the sureties' investigation of the situation following Morton's termination was woefully inadequate and provided no basis for the allegation that the government was in breach. Robert Kane, who at the time Morton was terminated headed Seaboard's Smithtown office and was closely involved at the beginning with providing the bond, testified that despite his knowledge of the project, his superiors at Seaboard never consulted him on how to proceed with regard to Morton's termination.

Finally, Seaboard was accused of instructing its consultants in the matter not to put any reports in writing, with the implicit suggestion that Seaboard officials knew that such reports would be adverse to their position and could damage the sureties' litigation stance. *See, e.g.*, testimony of Mark Pessolano that "Mr. Hart instructed them . . . to keep notes of their investigation but not to give him a written report", and a consultant's memorandum that Pessolano told him "keep your own in-house notes anyway (sic) you want to but do not put it in write (sic) to Seaboard Surety."

The stated purpose for introducing such evidence was the government's theory that it could recover damages in excess of the bond limit of $10,685,000 if it established bad faith on the part of the sureties, and it was for this purpose that the district court admitted it. The court instructed the jury that its damages could exceed the bond limit if it found bad faith, and included in the special interrogatories question 8, asking whether the sureties had acted in bad faith.

To admit the evidence of bad faith for this purpose was error. It is hornbook law that a surety is liable up to, and only up to, the limit on the bond it issued. *See, e.g., Pennsylvania Fire Insurance Co. v. American Airlines, Inc.*, 180 F. Supp. 239, 241 (E.D.N.Y. 1960); *Bill Curphy Co. v. Elliott*, 207 F.2d 103, 106 (5th Cir. 1953). Despite its claim of a "developing nationwide policy", the novel exception to this rule urged by the government is supported by little relevant precedent. The government's citation of *Transport Insurance Co. v. Michigan Mutual Liability Insurance Co.*, 496 F.2d 265 (6th Cir. 1974), is misleading at best, since that case dealt with insurance rather than suretyship law and, more importantly, it did

not hold, as the government claims, that a "surety has to determine if its principal has or has not breached the construction contract before it repudiates liability." Government's Brief at 33. Rather, it held that Michigan Mutual had *not* acted in bad faith, and reversed a district court finding to the contrary as clearly erroneous.

Some support for the government's theory is provided by *Continental Realty Corp. v. Andrew J. Crevolin Co.*, 380 F. Supp. 246, 253-55 (S.D.W.Va. 1974), in which Judge Merhige did find bad faith on the part of a surety, General Insurance Company. There, however, General's refusal to perform pursuant to the bond was in disregard of an injunction. *Id.* at 254. We need not consider whether in such circumstances a surety's bad faith could be considered so egregious as to render it liable for damages caused by its conduct in excess of the bond amount, since here there was no such injunction directing the sureties to perform.

The alleged bad faith of the sureties here amounted, for the most part, to no more than exercising their right to litigate the question of Morton's breach of contract. The government alleges no separate injury attributable to the sureties' purported bad faith (except delay in recovering its damages, which is fully compensated by the interest assessed on the judgment), but rather seeks only to recover the full quantum of damages attributable to Morton's breach. Where all alleged damages are the result of the principal's breach and not the surety's conduct, we hold that evidence of the surety's conduct is irrelevant. Hence, it was error to admit such evidence of bad faith by the sureties in this case.

2. *Lack of Prejudice to the Sureties.*

The standard for reversal based on the erroneous admission of evidence is set forth in Rule 61, Fed. R. Civ. P. It provides,

> No error in either the admission or the exclusion of evidence and no error or defect in any ruling or order or in anything done or omitted by the court or by any of the parties is ground for granting a new trial or for setting aside a verdict or for vacating, modifying, or otherwise disturbing a judgment or order, unless refusal to take such action appears to the court inconsistent with substantial justice. The court at every stage of the proceeding must disregard any error or defect in the proceeding which does not affect the substantial rights of the parties.

It does not appear on the record before us that upholding the judgment against the sureties is "inconsistent with substantial justice", nor did the admission of the bad faith evidence "affect the substantial rights" of the sureties.

To begin with, the evidence did not accomplish the specific erroneous result for which it was admitted, since the verdict did not exceed the penal sum of the bond. In order to show prejudice, then, the sureties must demonstrate that some element of the damages awarded by the jury—or the very finding of liability itself—was influenced by the evidence of bad faith. It is the sureties' burden to show prejudice, *Palmer v. Hoffman,* 318 U.S. 109, 116 (1943) ("He who seeks to have a judgment set aside because of an erroneous ruling carries the burden of showing that prejudice resulted."); *In re Air Crash Disaster at John F. Kennedy International Airport on June 24, 1975,* 635 F.2d 67, 70-71 (2d Cir. 1980), but the sureties have failed to sustain their burden. The strongest point they raise is that the jury obviously was persuaded by the evidence of bad faith since it answered "Yes" to question 8 of the special interrogatories that comprised its verdict, "Did the Sureties act in bad faith?" But standing alone,

the fact that the jurors were persuaded by the evidence does not mean that the evidence influenced their deliberations on the other issues in the case.

The key questions were whether the government or Morton had breached the construction contract, and, if Morton had done so, what the government was entitled to recover in damages. By far the vast majority of the 1,700 pages of trial transcript is devoted to the issue of which party had breached. In answer to question 2 of the special interrogatories, "Did Morton Company breach its agreement with the Government?", the jury answered "Yes." There was overwhelming evidence that Morton did in fact breach its construction contract with the government, and that the government thereby incurred millions of dollars in damages, spent in assessing the task of completion left to the government by Morton, repairing the poor work done by Morton, and, only then, actually completing the three buildings that available funding permitted. A fair reading of the record supports the jury's verdict as to Morton's breach; in fact, the sureties do not seem to be contending that the improperly admitted evidence influenced the outcome on that issue. Rather, they focus on damages.

While it is impossible to discern from the record precisely what formed the basis for the amount of damages awarded by the jury, it is clear that the jury did not simply adopt uncritically the claims of the United States. The government was asking for $11,420,000 in damages, but the jury awarded $10,631,326, or some $788,674 less. This supports the notion that the jury did in fact examine the damages claimed by the government, and gave judgment based on that examination rather than on the basis of its view of the sureties' conduct. Presumably, if the

jurors wished to punish the sureties for their bad faith they would have awarded the government at least as much as, and perhaps more than, the amount it was seeking. Of course, it is conceivable that the jury would have disallowed even more of the damages sought by the government if not for the bad faith found, but such a supposition is supported only by speculation.

The sureties seek to show that the damage award was affected by the evidence of bad faith by arguing that the jury failed to give them any credit for the value of work done by Morton immediately prior to termination and as reflected in "change orders" submitted by Morton that were pending when Morton was terminated. The sureties contend that the government "conceded" that the value of that work was $300,000, and that the failure of the jury to credit the sureties for at least that amount must be the result of the finding of bad faith.

This argument is, at best, strained. The sureties point to no logical connection between the change orders and the bad faith, and no such connection appears to exist. Moreover, the government's "concession" as to the change orders was accompanied by a statement that, even assuming the $300,000 value of that work, Morton had still been overpaid for the work it did on the entire project. In any event, the argument that the jury's refusal to credit the sureties with $300,000 in change orders is evidence of prejudice amounts to speculation, not proof or even plausible argumentation.

In sum, there is no claim by the sureties that the evidence of bad faith on their part in any way influenced the jury's conclusion that Morton, and not the government, had breached the contract. Since the government offered no proof—indeed, raised no argument—of any damages

except those caused by Morton's breach, there is no reason to believe that the amount of the damages awarded was due to anything other than that proof and that breach. The sureties have established no element of the damages that resulted from or was influenced by the erroneously admitted evidence. In short, "we cannot say that the ruling was prejudicial even if . . . it was erroneous." *Palmer v. Hoffman*, 318 U.S. at 116. *See also Bickerstaff v. S. Central Bell Tel. Co.*, 676 F.2d 163, 169 (5th Cir. 1982).

C. *Prejudgment Interest.*

The sureties finally contend that the district court erred in the amount of prejudgment interest it added to the damages found by the jury. We agree with the sureties that the district court's calculation of interest was incorrect, but not for the reasons advanced by the sureties. No statute or regulation governs the award of interest on a judgment based on a Miller Act bond, and therefore the entry of prejudgment interest is committed to the sound discretion of the district court. The court's decision here was, however, an abuse of discretion.

The sureties' argument that interest should have run from January 6, 1986, the date the current contracting officer issued a formal demand for payment once the completion work was finished, requires little comment. They contend that interest determinations are governed by the Federal Acquisition Regulations ("FARs"), 48 CFR § 1 *et seq.*, which require a demand for payment that shall include notice that interest will be assessed on any part of the demand remaining unpaid after thirty days. 48 CFR § 32.610(b)(2). The FARs, however, like the CDA, govern a debt incurred pursuant to a government contract, which a Miller Act performance bond is not, and specifically to a contract for the acquisition of supplies and services,

which as we noted in § A(1) above, a bond is certainly not. We see no more reason to expand the scope of the FARs to reach Miller Act bonds than we did similarly to expand the CDA.

The calculation of prejudgment interest was therefore committed to the discretion of the district court. *Rodgers v. United States,* 332 U.S. 371, 373 (1947); *EEOC v. County of Erie,* 751 F.2d 79, 81 (2d Cir. 1984). However, the purpose of prejudgment interest is compensatory, not penal. *See Rodgers, supra* (a party "who has suffered actual money damages by another's breach . . . should be fairly compensated" by entry of appropriate interest). Here, the quantum of interest assessed by the district court goes well beyond fairly compensating the government for the loss it sustained by virtue of the fact that the sureties denied liability on the bond.

The penal quality of the district court's award becomes clear upon consideration of what would have occurred had the sureties conceded, rather than denied, liability in 1980 and agreed to pay the completion costs. They would have had to reimburse the government as those costs were incurred; simultaneously, however, they would have had the full use of—and benefitted fully from the interest obtainable on—the money until it was actually paid to the government. Thus, assessing interest from the day the sureties denied liability—even if that action is viewed as something akin to an "anticipatory breach" rather than simply an assertion of the sureties' right to litigate their liability—penalizes them instead of merely compensating the government.

From the government's perspective, it was harmed only insofar as it was forced to pay for completion that should have been financed by proceeds from the bond. Interest,

therefore, cannot be assessed prior to the date the government began paying to complete the Plum Island project. Moreoever, after it terminated Morton, the government had $2,579,704 in appropriated funds that remained undisbursed from the original contract, money that it used to pay the initial costs of completion. This the government would have been obligated to do even had the sureties agreed to pay on the bond. Thus, the government was not legally or actually damaged by the sureties' failure to accept liability until its expenditures on completion exceeded $2,579,704. The sureties contend that that occurred in January 1983, but on remand the district court is free to hear argument and accept evidence on that question.

We recognize that a dollar-for-dollar, check-by-check calibration of the damages awarded by the jury with the government's completion expenditures is impossible. Since the verdict disallowed some of the claimed damages, and since it is impossible to discern which of the costs formed the basis for the award, there is no way to tie prejudgment interest to the exact date the government spent each dollar toward completion.

Fortunately, the district court need not, on remand, attempt the impossible: an exact calculation of payments on which interest would be due. The court has considerable discretion in assessing interest, and by our discussion of the framework that should guide its analysis we do not intend to suggest that the interest on each dollar of the verdict must be assessed only from the day it can be shown the government spent that dollar towards completion. So long as the district court's award of interest generally reflects a level that roughly and fairly compensates the government for those costs, it will fall within the range of

the court's discretion. We therefore remand for recalculation of prejudgment interest beginning no earlier than the date the government's post-default expenditures toward completion of the Plum Island project exceeded $2,579,704.

Affirmed in part, reversed in part, and remanded.

APPENDIX B

UNITED STATES COURT OF APPEALS
SECOND CIRCUIT

Docket No. 86-6145(L)
86-6163

At a stated term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Courthouse, in the City of New York, on the 11th day of June one thousand nine hundred and eighty- seven.

UNITED STATES OF AMERICA,
Plaintiff-Appellee Cross-Appellant,
-V-,
SEABOARD SURETY COMPANY and HOME INSURANCE COMPANY,
Defendants-Appellants, Cross-Appellees,

SEABOARD SURETY COMPANY and THE HOME INSURANCE COMPANY
Defendants-Third- Party-Plaintiffs,
-V-
JOSEPH MORTON COMPANY INC., JOSEPH BATTAGLIA, and THE PERKINS & WILL PARTNERSHIP,
Third-Party-Defendants.

A petition for rehearing containing a suggestion that the action be reheard in banc having been filed herein by counsel for the Appellants SEABOARD SURETY COMPANY.

Upon consideration by the panel that heard the appeal, it is

Ordered that said petition for rehearing is DENIED.

It is further noted that the suggestion for rehearing in banc has been transmitted to the judges of the court in regular active service and to any other judge that heard the appeal and that no such judge has requested that a vote be taken thereon.

Elaine B. Goldsmith
Clerk

APPENDIX C

United States Court of Appeals,
Federal Circuit

JOSEPH MORTON CO., INC.
Appellant/Cross-Appellee,

v.

The UNITED STATES,
Appellee/Cross-Appellant.

Appeal Nos. 84-826, 84-854.

March 15, 1985.

Contractor filed complaint setting forth a claim against the United states alleging wrongful termination of right to perform a construction contract. The Claims Court, 3 Cl.Ct. 120, sustained the default termination, but withheld judgment on the Government's proposed counterclaim. After briefing. The Claims Court, 3 Cl.Ct. 780, James F. Merow, J., held that the Government's claims were required to be the subject of a decision by a contracting officer. Appeals were taken. The Court of Appeals, Jack R. Miller, Circuit Judge, held that: (1) the fraud committed by the contractor with respect to a change order, which resulted in the conviction of the contractor for conspiracy to defraud the Government and knowingly submitting false and fraudulent cost statements to the Government, was sufficient to warrant termination of the contract by default, and (2) the Government was required to raise its claims before a contracting officer as a prerequisite to bringing suit in the Claims Court where the contractor elected to proceed under the Contract Disputes Act.

Affirmed.

William W. Thompson, Jr., Hudson, Creyke, Koehler & Tacke, Washington, D.C., for appellant/cross-appellee. With him on brief were John B. Tacke, Washington, D.C.

Richmond I. McKay, Commercial Litigation Branch, Dept. of Justice, Washington, D.C., for appellee/cross-appellant. With him on brief were Richard K. Willard, Acting Asst. Atty. Gen., David M. Cohen, Director and Thomas W. Petersen, Washington, D.C.

Before MILLER, Circuit Judge, SKELTON, Senior Circuit Judge, and NIES, Circuit Judge.

JACK R. MILLER, Circuit Judge.

These appeals are from a decision of the United States claims Court under the Contract disputes Act of 1978, Pub.L. No. 95-563, 92 Stat. 2383—91, 41 U.S.C. §§ 601-613 (1982) ("CDA"), and involve a contract for building construction at Plum Island, New York. They present two issues: (1) Whether the Claims Court committed reversible error in granting summary judgment dismissing the petition of appellant on the ground that, as a matter of law, fraud committed in one aspect of the contract prior to termination for default constitutes an independent basis for upholding the termination where the fraud was not expressly stated as a ground for termination by the Contracting Officer ("CO"); (2) whether the CDA mandates that Government claims related to a pre-CDA contract must first be the subject of a decision by a CO if, as in this case, the contractor elects to proceed under the CDA.

On the first issue (Appeal No. 84-826), we affirm the Claims Court's decision granting summary judg-

ment dismissing Morton's petition. On the second issue (Appeal No. 84-854), we affirm the Claims Court's decision denying the Government's motion for leave to file counterclaims because they have not been the subject of a decision by the CO.

Background

On September 24, 1976, Joseph Morton Company ("Morton") entered into a fixed price contract (No. 12-14-0605-192) with the Science and Education Administration of the Department of Agriculture for the construction of animal disease research facilities, including extensions to biohazard containment laboratories. The original amount of the competitively bid contract was $10,049,000, but it was changed by amendment of $10,779,997.

Throughout the term of the contract, the Government issued numerous change orders, field orders, and revisions to the drawings. Prior to initiation of the construction the Government issued the first substantive change order following the award of the contract, change order No. 2. This was a revision of the air handling and filtration system. On April 27, 1981, Morton was convicted in the United States District Court for the Eastern District of New York for the crimes of conspiring to defraud the Government (in respect to change order No. 2) under 18 U.S.C. §§ 2 and 371 and, in furtherance of the conspiracy, knowingly submitting false and fraudulent cost statements to the Government under 18 U.S.C. §§ 2, 1001, and 3237. *United States v. Joseph Morton Co.,* Docket No. CR-80-00413 (E.D.N.Y. Apr. 24, 1981), *aff'd,* Nos. 81-11174/1233 (2d Cir. Jan. 11, 1982). In the same action, the district court also convicted Morton

of obstructing justice by removing, concealing, and destroying documents requested by the grand jury pursuant to two *subpoenas duces tecum* related to the same change order under 18 U.S.C. §§ 2, 1503, and 3237. Morton was heavily fined, and two of its principal employees were sentenced to terms of imprisonment, which terms have been served.

The Government issued at least four cure notices in response to deficiencies by Morton during the course of the contract. The last cure notice was issued in February, 1979, and was fifty-five pages in length. It directed Morton to remedy the problems enumerated therein or demonstrate substantial progress toward compliance within ten days after receipt. Morton's response was considered unsatisfactory and, on March 28, 1979, the contract was terminated for default due to the alleged deficiencies.

Thereafter, on March 3, 1980, Morton filed for a Chapter 11 voluntary bankruptcy, which, if granted, would have permitted it to avoid liability for damages, including reprocurement costs. On March 1, 1982, the Government filed suit in the United States District court for the Eastern District of New York against Seaboard Surety Company ("Seaboard"), Morton's surety on the contract performance bond, seeking to recover under the bond for Morton's breaches of the contract. *United States v. Seaboard Surety Co.*, Civil Action No. CV-82-0518. The bankruptcy proceeding was dismissed on April 8 1983, thus dissolving the automatic stay and rendering Morton liable for its debts. *See* 11 U.S.C. § 362 (1982).

Also on March 1, 1982, Morton filed an action in the Court of Claims (now the Claims Court, to which the case was subsequently transferred), seeking to

convert the default termination into a termination for the convenience of the Government *Joseph Morton Co. v. United States,* No. 107-82C (Dec. 16, 1983). The thrust of its allegations was that it had been wrongfully terminated because the Government was, at least in part, responsible for Morton's alleged breaches, and that Morton adequately responded to the Government's last cure notice, issued in February, 1979.

On August 23, 1982, the Government moved for summary judgment sustaining the default termination—not on the basis of the asserted performance deficiencies which led to the CO's decision of March, 1979, but on Morton's convictions for false and fraudulent cost submissions. Although the Government denied that the contract was wrongfully terminated for alleged performance deficiencies, for purposes of the summary judgment motion and of this appeal, it has argued only fraud in support of the default termination on the contract and has not asserted performance deficiencies.[1] Morton opposed the summary disposition, arguing that a conviction for the submission of false documentation with respect to a single change order during the performance of a very large and complex contract does not permeate the entire contract and, therefore, does not support a default termination.

At the time the suit was filed, the Government could not counterclaim for damages, because of the temporary automatic stay imposed under the bankruptcy proceedings and the pending suit against Mor-

[1] The Government also asserted as an affirmative defense 28 U.S.C. § 2514 (1982), Forfeiture of fraudulent claims, which the Claims Court did not address due to its disposition of the case.

ton's surety. However, on May 24, 1983, after the bankruptcy proceedings were terminated and the stay lifted, the Government moved the court for permission to amend its answer to assert two counterclaims: one for common law breach of contract, and the other for excess reprocurement costs. On July 12, 1983, the Claims Court sustained the default termination. *Joseph Morton Co. v. United States,* 3 Cl.Ct. 120 (1983). Entry of the judgment was deferred, however, to allow Morton to respond to the Government's motion to amend.

At some point between April 8, 1983, when Morton's bankruptcy proceedings were terminated, and November 18, 1983, the date of the Claims Court's opinion on the Government's motion to add the counterclaims, Seaboard impleaded Morton as a third-party defendant in the pending Eastern District of New York suit.[2] *Joseph Morton Co. v. United States,* 3 Cl.Ct. 780, 782 (1983). In the Claims Court, Morton opposed the filing of the Government's proposed counterclaims on the grounds that (1) the July 12, 1983, Claims Court opinion effectively dismissed the complaint in that forum so that no counterclaim could be filed, and (2) a contracting officer's decision is a prerequisite to the assertion of the Government's claims and, thus, the Government's claims were premature.

In its November 18 opinion, the Claims Court stated that the prerequisite for its jurisdiction over counterclaims is the filing of a claim within the jurisdiction of the court under 28 U.s.C. §§ 1503, 2508 (1982). It found that, in this case, although Morton's claim

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[2] The exact date of the termination is not in the record before us, but it is unimportant for purposes of this opinion.

lacked merit, the original claim set forth a contract claim against the United States and, thus, fulfilled the requirement; further, that even though the counterclaims were not asserted within the normal response period during the pleading stage of the litigation, the exercise of the court's discretion to permit amendment at this time would fit squarely within the bounds of statutory and decisional law. "[T]he procedure generally employed is to defer entry of a final judgment on a plaintiff's claim within the court's jurisdiction pending final resolution of any counterclaim(s) correctly asserted in the matter involved." *Joseph Morton Co.*, at 783, *citing Astro-Space Laboratories, Inc. v. United States*, 470 F.2d 1003 (Ct.Cl.1972).

In response to Morton's second ground for opposing the Government's counterclaims, the court cited the CDA and decisional law in concluding that the United States cannot assert its claims first in the Claims Court if Morton elects to bring those claims under the CDA. *Joseph Morton Co.*, at 783–784. It found that the contract to which Morton was a party is covered by section 16 of the CDA, Public Law 95–563. The Claims Court said that this provision governs the contract in suit and adopted the interpretation of its predecessor, the Court of Claims, namely: that the provision permits the contractor to elect whether a Government claim, initiated after enactment of the CDA, must be brought only under the provisions of the CDA. *Joseph Morton Co.*, at 783. Under the CDA, the Government is bound by 41 U.S.C. § 605(a), which requires all Government claims to be "the subject of a decision by the contracting officer." 41 U.S.C. § 605(a). The Claims Court or-

dered Morton to file a statement electing whether or not to proceed under the CDA with respect to the Government's counterclaims. Morton elected to proceed under the CDA, and, by an order and judgment dated December 16, 1983, its complaint was dismissed, thereby effectively denying the Government's motion for leave to file an amended answer and counterclaims.

Discussion

(a) *Appeal 84-826, Newly Discovered Grounds for Prior Termination*

On this point, Morton argues that its claim should not have been dismissed, because the commission of a crime does not always constitute a material breach of contract, and the court should have taken into consideration factors such as the nature and extent of the fraud committed; also, that only one of the many change orders was tainted; further, that reliance by the Government on prior false statements is an *"ex post facto"* justification for a default termination and is improper where the Government is seeking money damages; in addition, the relationship of the fraud to the contractor's performance should have been assessed, because even if Morton's prior acts can be asserted after a termination for convenience, its overall performance should have been examined to determine whether its actions warranted default termination.

Next, Morton argues that the ruling of the Claims Court deprived it of fundamental fairness, because it exposed Morton and its surety to a potential liability of about $14 million—a much greater amount that it had been penalized for violating the provisions of Title

18. However, in *United States v. Acme Process Equipment Co.*, 385 U.S. 138, 87 S.Ct. 350, 17 L.Ed.2d 249 (1966), the Court stated:

> [W]here there is commercial bribery in the form of a kickback, there is something specific which the Government can recover, and hence it was quite natural for Congress to provide this express remedy. There is absolutely no indication in the legislative history of the Anti-Kickback Act that Congress, in providing a civil remedy for a more tangible evil, intended to preclude other civil sanctions necessary to effectuate the purpose of the Act.

385 U.S. at 145, 87 S.Ct. at 355.[3] The Court thus ruled that a criminal statute which explicitly provides a civil penalty may support another sanction to effectuate the policy underlying the statute. We are not persuaded by Morton's assertion that imposition of a potentially large penalty would infringe its due process rights.

With respect to Morton's first argument, "[I]t is settled law that a party can justify a termination if there existed at the time an adequate cause, even if then unknown." *Pots Unlimited, Ltd. v. United States*, 600 F2d 790, 793 (Ct.Cl.1979) (citations omitted). Therefore, if the fraud committed by Morton during performance would support the Government's termination for default if discovered before termination of the contract, evidence of such fraud discovered thereafter would also support a default termination.

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[3] Although the Court was referring to a criminal violation of the Anti-Kickback Act, its language is equally applicable to Morton's fraud in this case.

Morton does not dispute this but asserts that its fraud did not rise to the level necessary to "taint" the entire performance.[4] It points out that there were approximately 950 alterations and change orders by the Government and asserts that a court should balance the one act of its admitted fraud against its overall performance and good behavior on the other aspects of the contract. This, it says, would show that the fraud was *de minimis* and did not taint the entire contract. Morton adds that the court should consider that the Government's alterations to the contract were so numerous and "hopelessly defective" that it was error for the Claims Court to find that the fraud it committed on the United States mandates a termination for default.[5]

The Government replies that only 32 change orders were executed, but concedes that, in addition, approximately 525 proposed alterations and drawing amendments were made. The precise number is impossible to assess from the record before us and neither party's assertion is substantiated. The Government asserts that, although Morton was convicted on only one fraud count, the aspect of the contract to which the change order related was fundamental to the contract; thus, the impact of the fraud in this procurement was substantial.

In our view, the number of alterations, whether 950 or 525, is irrelevant. On any complex Government

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[4] The effect of dismissal of Morton's claim would be that it fails to attain its objective that the court change termination from default to convenience.

[5] In essence, Morton proposes something akin to comparative fault.

contract, a large number of alterations is likely. For instance, during congressional hearings on the CDA, Admiral H.G. Rickover testified that it is not unusual for there to be as many as 3,350 changes in a complex contract for the Navy. *See Hearings on S. 2292, S. 2787, S. 3178 Before the Subcomms. On Federal Spending Practices and Open Government, Governmental Affairs, Citizens and Shareholders Rights and Remedies and The Judiciary,* 95th Cong., 2d Sess. 39–40 (1978). In the instant case, the contract was for the construction of animal disease research facilities, and the 525 to 950 alterations or proposals made by the Government, while not small, is not of the mind-boggling magnitude that Morton suggests. A contractor such as Morton assuming the responsibilities of performing a large, sophisticated contract for the Government should expect changes.

Morton's point that the court should perform a balancing test between its one fraudulent act and the amount of work performed "free" of fraud is contrary to precedent. The Claims Court relied on several recent cases in declaring that "[a] contractor which engages in fraud in its dealings with the government on a contract has committed a material breach justifying a termination of the entire contract for default." *Joseph Morton Co.,* 3 Cl.Ct. at 122, *citing College Point Boat Corp. v. United States,* 267 U.S. 12, 15–16, 45 S.Ct. 199, 200–201, 69 L.Ed. 490 (1925); *Pots Unlimited, Ltd. v. United States, supra.* In *United States v. Acme Process Equipment Co., supra,* the court held that the Anti-Kickback Act, which clearly expresses a policy opposed to kickbacks, authorizes the cancellation of a Government contract.

Justice Black, writing for the Court, stated the *ratio decidendi* as follows:

> [E]ven if the Government could isolate and recover the inflation attributable to the kickback, it would still be saddled with a subcontractor who, having obtained the job other than on merit, is perhaps entirely unreliable in other ways. This unreliability in turn undermines the security of the prime contractor's performance—a result which the public cannot tolerate, especially where, as here, important defense contracts are involved.

385 U.S. at 144-45, 87 s.Ct. at 355. This statement underscores the necessity for the Government to be secure in its confidence in its contractors.

In *K & R Engineering Co. v. United States*, 616 F.2d 469 (Ct.Cl.1980), a contractor brought suit to recover damages for an alleged breach of contract terminated for convenience by the Government. The court held that the Government was entitled to recover the amount paid under contracts that had been procured through the contractor's violation of the conflict of interest statute, 18 U.S.C. § 208(a).

The policy underlying the statutory precursor to the present conflict of interest statute was further explained in *United States v. Mississippi Valley Generating Co.*, 364 U.S. 520, 81 S.Ct. 294, 5 L.Ed.2d 268 (1961), in which the Court stated that—

> protection [of the public] can be fully accorded only if contracts which are tainted by a conflict of interest on the part of a government agent may be disaffirmed by the Government. . . . Were we to decree the enforcement of such a contract, we would be affirmatively sanctioning the type

> of infected bargain which the statute outlaws and we would be depriving the public of the protection which Congress has conferred.

364 U.S. at 563, 81 S.Ct. at 316.

Thus, there is support for the argument that any fraud warrants termination for default as a matter of law. *See also Brown v. United States,* 524 F.2d 693 (Ct. Cl.1975). However, we merely hold that, in this case, the fraud committed by Morton was sufficient to warrant termination of the contract by default.

(b) *Appeal 84-854*

In appeal 84-854, the Government's position is that the claims Court erred in holding that its counterclaims must be resolved by a CO due to Morton's election to proceed under the CDA. It contends that the Claims Court misinterpreted section 16 of the CDA; that the pre-CDA contract contained the standard default clause which reserved to the Government common law remedies that could only have been brought in a federal district court; and that, in any event, since the CDA provides that no agency heads may adjust any claim involving fraud, a CO is not empowered to resolve the claims of the Government.

(1) Interpretation of "any claim" Language of CDA

This issue turns on whether the Government is subject to the CDA. If so, 41 U.S.C. § 605(a) applies, which provides in pertinent part: "All claims by the government against a contractor relating to a contract shall be the subject of a decision by the contracting officer. . . ." *See Paragron Energy Corp. v.*

United States, 645 F.2d 966 (Ct.Cl.1981). Thus, if the CDA applies, the Government's counterclaims against Morton must be subject to a decision by a CO before the Government can assert them in the Claims Court.

Section 16 of the CDA (originally proposed in the bill as section 15) was enacted to serve the purpose of a grandfather clause. It prescribes when application of the Act becomes mandatory and it also attempts to dictate the course of actions dependent on contracts entered into before the bill was signed, thus:

> "This Act . . . shall apply to contracts entered into one hundred twenty days after the date of enactment. . . . Notwithstanding any provision in a contract made before the effective date of this Act, *the contractor may elect to proceed under this Act with respect to any claim pending then before the contracting officer or initiated thereafter.*"

41 U.S.C. § 601, Note entitled "Effective Date" (emphasis supplied). Although the Government disputes the applicability of the clause (and thus the CDA) because the contract in question was entered into in 1976 (before the effective date of the CDA), the universally accepted meaning of the provision is that "[t]he act shall apply to all contracts made after the effective date of the act. However, the contractor may elect to proceed under the provisions of the act even if the contract was made prior to the effective date of the act." H.R.Rep. No. 1556, 95th Cong., 2d Sess. 11 and 33 (1978). In this case, of course, Morton has so elected.

The dispute here is over the phrase underscored in the above quotation. Morton argues that the words "any claim" refer to *any* claim, by the contractor or

by the Government; whereas, the Government asserts that they refer to only claims by the contractor. They have been interpreted by only two appellate courts: the Court of Claims in *Tester corp. v. United States,* 227 Ct.Cl. 648 (1981), and the First circuit in *Woods Hole Oceanographic Institution v. United States,* 677 F.2d 149 (1st Cir. 1982). There is a total conflict between these interpretations.

The Claims Court has followed *Tester Corp.,* where the court held that the contractor, at its discretion, could bring within the provisions of the CDA a pre-CDA contract claim by the Government pending before the CO on the effective date of the CDA. Unfortunately, neither the first Circuit, in its *Wood's Hole* opinion, nor the Court of Claims in *Tester Corp.* based its interpretation on the legislative history of the CDA.

The first step in determining the meaning of statutory language is to ascertain its plain meaning. In this case, the words "any claim" could be no plainer. If Congress had intended them to exclude claims of the *Government,* it would hardly have used the word "any." Moreover, a review of the legislative history of the CDA relating to section 16 is persuasive that there existed no such intent.

The purpose of congress in promulgating the CDA was "[t]o provide for the resolution of claims and disputes relating to Government contracts. . . . Pub.L. No. 95-563, 92 Stat. 2382 (Nov. 1, 1978). The CDA provides that each claim must first be subject to a determination by a CO, a person with expertise in the administration of Government contracts—often in the field of the contract at issue. Also, the CO has had experience in dealing with the parties in suit and

is likely to understand the problems involved and the claims asserted by each party. It is, therefore, appropriate for the CO to render a decision on claims before they are asserted elsewhere.

We take note that the Claims Court possesses broad discretion in exercising its power to consolidate. Section 10(d) of the CDA, 41 U.S.C. § 609(d), *Consolidation,* provides for consolidation of cases by the Claims Court. The legislative history emphasizes the importance of consolidation of suits:

> It is the intent of the committees that splitting of the causes of action, or suits, under one contract be kept to a minimum. . . . [I]t is intended that the Court of Claims have the same ultimate authority to consolidate suits that are split between the court and the agency boards. . . .
>
> . . .It is the intent of the section to make available the opportunity to consolidate like suits in one jurisdiction, but this action should weigh the positions of the parties involved.

S.Rep. No. 1118, 95th Cong. 31, *reprinted in* 1978 U.S.Code Cong. & Ad.News 5235, 5265. Thus, where the Claims Court has a contractor claim before it and the contractor elects to proceed under the CDA, the court possesses the power to stay such a claim pending the CO's determination of a Government counterclaim, and to then consolidate the claims for trail.

The Government argues that the holding (Government's counterclaim not subject to CDA and may be brought without CO decision) and reasoning of the First Circuit should prevail but merely quotes conclusory statements from *Wood's Hole* and ignores the holding in *South Corp. v. United States,* 690 F.2d 1368, 215 USPQ 657 (Fed. Cir.1982) that makes the

Court of Claims decision in *Tester Corp.* binding precedent on this court.

The governments argument that certain provisions of the pre-CDA contract before us preclude application of the CDA is expressly refuted by language in the provision at issue: "*Notwithstanding any provision in a contract made before the effective date of this Act,* the contractor may elect to proceed under this Act. . . ." (Emphasis supplied.)

(2) No Preclusion of Decision by CO by Fraudulent Activity in Performance of Contract

The Government asserts that the CDA does not apply to any of the Government's claims, but that, if it does, the last sentence of 41 U.S.C. § 605(a) applies to remove its claims from the jurisdiction of the CO. The last sentence of section 605(a) provides: "This section shall not authorize any agency head to settle, compromise, pay, or otherwise adjust any claim involving fraud." Because fraud is the basis for its counterclaims argues the Government, the authority to decide Government claims explicitly granted in the second sentence of the same section is nullified.

This argument fails for two reasons. First, the government does not even suggest that the term "contracting officer," who, under the second sentence of section 605(a), shall decide "[a]ll claims by the government," and the term "agency head" in the sentence quoted above, are equivalents. Unless this can be shown, the fact that an agency head does not have a particular grant of authority neither adds to nor subtracts from the authority granted a contracting officer. We are persuaded that the use by Congress of two different terms in the same paragraph of the

statute manifests an intent that they not be considered equivalents.

Second, even if the Government were to show that Congress intended "agency head" to refer "contracting officer," there is a clear indication in the legislative history that Congress did not intend the word "claim" to mean the whole case between the contractor and the Government; but, rather, that "claim" mean each claim under the CDA for money that is one part of a divisible case. S.Rep. No. 1118 (on S. 3178, a precursor of the bill that became Pub.L. No. 95-563), 95th Cong., 2d Sess. 20, *reprinted in* 1978 U.S.Code Cong. & Ad.News at 5254. Morton's fraud has already been determined. Thus, liability for reprocurement costs and damages will not be an issue before a CO. Those claims, which are clearly not inextricably linked with liability for fraud, must first be the "subject of a decision by the contracting officer." 41 U.S.C. § 605(a). For the foregoing reasons, we hold that the Government's counterclaims must first be raised before a CO.

(c) Government's Allegation of Compulsory Counterclaims

Because the Government's counterclaims do not fit within the definition of a Rule 13(a) compulsory counterclaim, the issue of whether the Claims court properly refused to permit a compulsory counterclaim need not be reached.

In view of the foregoing, the decisions of the Claims Court are *affirmed.*

Each party shall bear its own costs.

AFFIRMED.

APPENDIX D

United States Claims court

No. 107-82C.

JOSEPH MORTON CO., INC.
v.
The UNITED STATES.
Nov. 18, 1983.

Contractor filed complaint setting forth contract claim against United States, alleging wrongful termination of right to perform construction contract. The Claims Court sustained default termination, but withheld judgment to await briefing on issue of whether government's proposed counterclaim for excess reprocurement costs and breach of contract could be asserted in action. After such briefing, the Claims Court, Merow, J., held that: (1) as initial complaint was clearly within jurisdiction of claims Court, and Court deferred entry of final judgment on claim pending final resolution of counterclaims, fact that Court concluded that contract claim was not meritorious did not deprive it of counterclaim jurisdiction, and (2) contractor had option to proceed under Contract disputes Act at its election.

Ordered accordingly.

John B. Tacke, Washington, D.C., for plaintiff; Hudso, Creyke, Koehler & Tacke, Washington, D.C., of counsel.

Richmond I. McKay, Washington, D.C., with whom was Asst. Atty. Gen., J. Paul McGrath, Washington, D.C., for defendant.

OPINION

MEROW, Judge:

This matter comes before the court on defendant's motion for leave to file an amended answer and counterclaims, and plaintiff's opposition thereto. Defendant seeks leave to file an amended answer asserting counterclaims for breach of contract and for excess reprocurement costs. The counterclaims stem from the default termination in 1979 of plaintiff's right to perform a 1976 contract for the construction of certain buildings at the United States Department of Agriculture Animal Disease Center located on Plum Island, New York.

Background

The opinion filed July 12, 1983 in this matter sustained the default termination of plaintiff's right to perform the Plum Island construction contract involved. Judgment was not entered to await briefing on the issue of whether defendant's proposed counterclaims for excess reprocurement costs and for breach of contract can or should be asserted in this action. In this regard, defendant has instituted litigation against plaintiff's performance bond surety, Seaboard Surety Company, in the United States District court for the Eastern District of New York, Civil Action No. CV-82-0518, to recover damages incurred in obtaining the completion of the defaulted Plum Island construction contract. Seaboard Surety Company has impleaded plaintiff in this District Court action as a third-party defendant, asserting an indemnity claim against plaintiff covering any sums Seaboard may be held liable to pay the United States under its Miller Act (40 U.S.C. § 2070a et seq.) per-

formance bond for the Plum Island contract. The Agriculture Department buildings covered by the contract on which plaintiff defaulted have not, as yet, been completed so that the total amount of any excess reprocurement cost incurred by the government has not been determined. To date, no contracting officer decision has been issued setting forth a claim against plaintiff for either breach of contract damages or for excess reprocurement costs stemming from the default of plaintiff's right to perform the Plum Island contract.

Discussion

Plaintiff opposes the filing of defendant's proposed counterclaims on several grounds.

First, plaintiff treats the opinion of July 12, 1983 as, in effect, dismissing its Claims Court complaint and urges that no counterclaim may be filed absent an extant complaint in this court.

Counterclaim jurisdiction in the Claims Court rests on 28 U.S.C. §§ 1503, 2508. This counterclaim jurisdiction requires, as a prerequisite, the existence of a claim filed against the United States within the jurisdiction of the Claims Court. *Mulholland v. United States,* 175 Ct.Cl. 832, 846, 361 F.2d 237, 245 (1966). Absent the prior filing by a plaintiff of a claim against the United States within the jurisdiction of the Claims Court any counterclaim then asserted by the United States under 28 U.S.C. §§ 1503, 2508 (1976) could, conceptually, encounter a constitutional objection because the Claims Court cannot provide a trial by jury. However, in *McElrath v. United States,* 102 U.S. 426, 430–40, 26 L.Ed. 189 (1880), it was ruled, with respect to the exercise of jurisdiction by an Article I

court under the provisions now codified as 28 U.S.C. §§ 1503, 2508, that:

> There is nothing in these provisions which violates either the letter or spirit of the Seventh Amendment. Suits against the government in the Court of Claims, whether reference be had to the claimant's demand, or to the defence, or to any set-off, or counterclaim which the government may assert, are not controlled by the Seventh Amendment. They are not suits at common law within its true meaning. The government cannot be sued, except with its own consent. It can declare in what court it may be sued, and prescribe the forms of pleading and the rules of practice to be observed in such suits. It may restrict the jurisdiction of the court to a consideration of only certain classes of claims against the United States. Congress, by the act in question, informs the claimant that if he avails himself of the privilege of suing the government in the special court organized for that purpose, he may be met with a set-off, counterclaim, or other demand of the government, upon which judgment may go against him without the intervention of a jury, if the court, upon the whole case, is of opinion that the government is entitled to such judgment. If the claimant avails himself of the privilege thus granted, he must do so subject to the conditions annexed by the government to the exercise of the privilege. Nothing more need be said on this subject.

See also Cherry Cotton Mills, Inc. v. United States, 327 U.S. 536, 66 S.Ct 729, 90 L.Ed. 835 (1946);

Frantz Equipment Co. v. United States, 122 Ct.Cl. 622, 105 F.Supp. 490 (1952).

Thus, if it is determined that a complaint filed in the Claims Court does not state a claim within the limited jurisdiction provided to this court, the dismissal of the complaint for lack of jurisdiction carries with it the dismissal of any counterclaim filed in the matter by the United States. *Mulholland v. United States,* 175 Ct.Cl. 832, 846, 361 F.2d 237, 245 (1966); *Somali Development Bank v. United States,* 205 Ct.Cl. 741, 751–52, 508 F.2d 817, 822 (1974).

In the instant matter, plaintiff filed a complaint setting forth a contract claim against the United States clearly within the jurisdiction of the Claims Court under 28 U.S.C. § 1491. The fact that it has been concluded that plaintiff's pleaded contract claim is not meritorious does not deprive the Claims Court of counterclaim jurisdiction in this matter under 28 U.S.C. §§ 1503, 2508. Rather, the procedure generally employed is to defer entry of a final judgment on a plaintiff's claim within the court's jurisdiction pending final resolution of any counterclaim(s) correctly asserted in the matter involved. *Astro-Space Laboratories, Inc. v. United States,* 200 Ct.Cl. 282, 312–13, 470 F.2d 1003, 1020 (1972). The opinion filed July 12, 1983 follows this accepted procedure.

Plaintiff next opposes the filing of defendant's proposed counterclaims for breach of contract damages and excess reprocurement costs on the bases that a contracting officer's decision is a prerequisite to the assertion of the government's claims and that the government's claims are premature.

Section 6(a) of the Contract Disputes Act, 41 U.S.C. § 605(a) (CDA), provides (in part) that "All claims by

the government against a contractor relating to a contract shall be the subject of a decision by the contracting officer." If the government claims in this matter can be brought under the term of the CDA, a contracting officer's decision is required as a prerequisite to court or board action with respect to them. *Paragon Energy Corp. v. United states,* 227 Ct.Cl. 176, 645 F.2d 966 (1981); *Space Age Engineering, Inc.,* ASBCA No. 26028, 82-1 BCA ¶15,766.

The Plum Island construction contract involved in this matter was executed in 1976. While the CDA did not go into effect until March 1, 1979, it also provided that "[n]otwithstanding any provision in a contract made before the effective date of this Act, the contractor may elect to proceed under this Act with respect to any claim pending then before the contracting officer or initiated thereafter." Sec. 16, Pub.L. No. 95-563, 92 Stat. 2383, 2391, 41 U.S.C. § 601 note (Supp. III 1979).

In *Tester corp. v. United States,* 227 Ct.Cl. 648, 651 (1981), the Court of Claims ruled that a government claim, on a 1975 contract, that was pending before the contracting officer on March 1, 1979 could, at the election of the contractor, be brought under the terms of the CDA. After withdrawing an opinion reaching a result consistent with *Tester,* in *Woods Hole Oceanographic Institution v. United States,* 677 F.2d 149, 156 (1st Cir. 1982), the court construed the above-quoted CDA language "as limited to claims of the contractor, not of the government." A review of the pertinent legislative history of the CDA discloses no support for this interpretation excluding government claims from the coverage election permitted to contractors under section 16. *See McDonnell Douglas*

Corp., ASBCA No. 26747, 83-1 BCA ¶ 16,377 at p. 81,418.

Rather, it is concluded that the plain meaning of the CDA should control and that, on a pre-Act contract, a contractor may elect to proceed under the CDA with respect to "any claim," including a government claim, initiated after March 1, 1979. *See F. Alderete General Contractors v. United States*, Fed.Cir., 715 F.2d 1476 (1983).

To enable a contractor to make the election provided by CDA section 16, all contract claims initiated after March 1, 1979 should be the subject of a contracting officer's decision as is contemplated by section 6 of the CDA. 41 U.S.C. § 605.

Were contracting officer decisions now to be issued on the damage and excess cost claims defendant proposes as counterclaims in this matter, several courses of action would then be open to plaintiff. If plaintiff elected CDA coverage, an appeal on both claims could be taken to the requisite board (Sec. 7, 41 U.S.C. § 606) or, alternatively, an action could be filed on both matters in the Claims Court (Sec. 10(a)(1), 41 U.S.C. § 609). If plaintiff did not elect CDA coverage, an appeal to the requisite contract appeals board would, presumably, be required under the disputes clause of the contract only with respect to the government's excess reprocurement cost claims (for relief available under the contract) and the government would be free to assert and prosecute a breach of contract claim as a *de novo* Claims court counterclaim. *United States v. Utah Construction and Mining Co.*, 384 U.S. 394, 86 S.Ct. 1545, 16 L.Ed.2d 642 (1966); *United States v. Anthony Grace & Sons, Inc.*, 384 U.S. 424, 86 S.Ct. 1539, 16 L.Ed.2d 662 (1966); *Marley v. United States*, 191 Ct.Cl. 205, 423 F.2d 324 (1970).

However, under pre-CDA contract disputes procedure, the *de novo* prosecution, in court, of a so-called "breach" action is usually deferred to await the conclusion of any related disputes clause proceeding before a board of contract appeals. *See Nager Electric Co. v. United States,* 177 Ct.Cl. 234, 255, 368 F.2d 847, 861 (1966). One reason for this practice is to gain the benefit of administrative factual determinations common to both actions which would then, if appropriately supported, not require relitigation in court. *United States v. Utah Construction and Mining Co.,* 384 U.S. 394, 86 S.Ct. 1545, 16 L.Ed.2d 642 (1966).

Normally, leave to amend a pleading should be freely given unless the amendment would be futile or unless there is undue prejudice to the opposing party. *Foman v. Davis,* 371 U.S. 178, 83 S.Ct. 227, 9 L.Ed.2d 222 (1962).

Given the conclusion that the government's claims can, at the election of the contractor, proceed under the CDA, the first step is to obtain the required election decision. In its opposition to the filing of the government's counterclaims, it is not considered that plaintiff has set forth an unequivocal election that the claims shall proceed under the CDA. If plaintiff so elects, it would be futile and inappropriate to grant leave to file the counterclaims. This is because, upon the issuance of the required contracting officer decisions under the CDA, it will then be plaintiff's election to: (1) take no timely action so that the decisions would then become final (Sec. 6(b), 41 U.S.C. § 605 (b)); or (2) appeal the decisions to the contract appeals board (Sec. 7, 41 U.S.C. § 606); or (3) file a direct action(s) in the United States Claims Court (Sec. 10(a),

41 U.S.C. § 609))[1] Any Claims Court action would be initiated by the contractor, not by the government. The government is not provided an election, under the CDA, to bring a government claim before the Claims Court rather than before a board of contract appeals.

If, however, plaintiff elects not to invoke CDA coverage over defendant's claims, then, as noted previously, defendant has a right to plead a breach of contract claim as a counterclaim in this matter and leave to so plead would be granted. Leave to file an excess reprocurement cost claim would not be granted as *de novo* action on such a claim in this court would not be available under established precedents. *See Zidell Explorations, Inc. v. United States,* 192 Ct.Cl. 331, 427 F.2d 735 (1970).[2] The matter could come

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[1] Section 14(i) of the CDA specifically amended 28 U.S.C. § 1491 to grant the Claims Court jurisdiction "to render judgment upon any claim by or against, or dispute with, a contractor arising under the Contract Disputes Act of 1978." Pub.L. No. 95-563, 92 Stat. 2391. Prior to this express grant of "disputes" jurisdiction, it was necessary for a contractor to pay any claim assessed against it by the government and then sue for a refund in order to have the money claim "against" the United States then required by 28 U.S.C. § 1491. *Computer Wholesale Corp. v. United States,* 214 Ct.Cl. 786, 566 F.2d 1189 (1977).

[2] *De novo* proceedings on the breach of contract counterclaim would, undoubtedly, be suspended to await completion of mandatory administrative proceedings on the government's related excess reprocurement cost claim and, perhaps, to await conclusion of the District Court performance bond litigation now pending between defendant and Seaboard Surety Company in which plaintiff is a third-party defendant. *See Department of Natural Resources and Conservation of the State of Montana v. United States,* 1 Cl.Ct. 727, 737-43 (1983). The pendency of this District Court litigation does not preclude the filing of a counterclaim

before the Claims Court only for judicial review of any ensuing decision of the board of contract appeals. *W.M. Schlosser Co. v. United States*, 705 F.2d 1336, 1339 (Fed.Cir.1983).

Conclusion

Based upon the foregoing discussion, it is ORDERED:

(1) On or before December 16, 1983 plaintiff shall file a "Statement" with the clerk of the court setting forth an election either to proceed under the CDA with respect to defendant's proposed counterclaims or an election not to proceed under the CDA with respect to defendant's proposed counterclaims;

(2) In the event plaintiff's statement under (1) is an election to proceed under the CDA, defendant's motion for leave to file an amended answer and counterclaims is denied and a final judgment shall be entered in favor of defendant and against plaintiff dismissing the complaint on the basis of the opinion filed July 12, 1983;

(3) In the event plaintiff's statement under (1) is an election not to proceed under the CDA, defendant's motion for leave to file an amended answer and counterclaims is granted only to the extent of leave to file a counterclaim for breach of contract and is otherwise denied with an appropriate amended answer and counterclaim to be filed within 20 days of the service of plaintiff's statement electing not to proceed under the CDA.

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on the same subject matter in the Claims Court as 28 U.S.C. § 1500 does not apply to government claims. *Universal Fiberglass Corp. v. United States*, 210 Ct.Cl. 206, 218, 537 F.2d 393, 399 (1976).

APPENDIX E

CONTRACT DISPUTES ACT OF 1978

41 U.S.C. § 601. Definitions

As used in this Act—

(1) the term "agency head" means the head and any assistant head of an executive agency, and may "upon the designation by" the head of an executive agency include the chief official of any principal division of the agency;

(2) the term "executive agency" means an executive department as defined in section 101 of title 5, United States code [5 USCS § 101], an independent establishment as defined by section 104 of title 5, United States Code [5 USCS § 104] (except that it shall not include the General Accounting Office): a military department as defined by section 102 of title 5 United States Code [5 USCS § 102], and a wholly owned Government corporation as defined by section 846 of title 31, United States Code [31 USCS § 846], the United States Postal Service, and the Postal Rate Commission;

(3) The term "contracting officer" means any person who, by appointment in accordance with applicable regulations, has the authority to enter into and administer contracts and make determinations and findings with respect thereto. The term also includes the authorized representative of the contracting officer, acting within the limits of his authority;

(4) the term "contractor" means a party to a Government contract other than the Government;

(5) The term "Administrator" means the Administrator for Federal Procurement Policy ap-

pointed pursuant to the Office of Federal Procurement Policy Act;

(6) The term agency board" means an agency board of contract appeals established under section 8 of this Act [41 USCS § 607]; and

(7) The term "misrepresentation of fact" means a false statement of substantive fact, or any conduct which leads to a belief of a substantive fact material to proper understanding of the matter in hand, made with intent to deceive or mislead.

(Nov. 1, 1978, P.L. 95-563, § 2, 92 Stat. 2383.)

§ 602. Applicability of law

(a) Unless otherwise specifically provided herein, this Act applies to any express or implied contract (including those of the nonappropriated fund activities described in sections 1346 and 1491 of title 28, United States Code [28 USCS §§ 1346, 1491]) entered into by an executive agency for—

(1) the procurement of property, other than real property in being;

(2) the procurement of services;

(3) the procurement of construction, alteration, repair or maintenance of real property; or,

(4) the disposal of personal property.

(b) With respect to contracts of the Tennessee Valley Authority, the provisions of this Act shall apply only to those contracts which contain a disputes clause requiring that a contract dispute be resolved through an agency administrative process. Notwithstanding any other provision of this Act, contracts of the Tennessee Valley Authority for the sale of fertilizer or electric power or related to the conduct or operation of the electric power system shall be excluded from the Act.

(c) This Act does not apply to a contract with a foreign government, or agency thereof, or international organization, or subsidiary body thereof, if the head of the agency determines that the application of the Act to the contract would not be in the public interest.

(Nov. 1, 1978, P.L. 95-563, § 3, 92 Stat. 2383.)

§ 604. Fraudulent claims

If a contractor is unable to support any part of his claim and it is determined that such inability is attributable to misrepresentation of fact or fraud on the part of the contractor, he shall be liable to the Government for an amount equal to such unsupported part of the claim in addition to all costs to the Government attributable to the cost of reviewing said part of his claim. Liability under this subsection [section] shall be determined within six years of the commission of such misrepresentation of fact or fraud.

(Nov. 1, 1978, P.L. 95-563, § 5, 92 Stat. 2384.)

§ 605. Decision by the contracting officer

(a) All claims by a contractor against the government relating to a contract shall be in writing and shall be submitted to the contracting officer for a decisions. All claims by the government against a contractor relating to a contract shall be the subject of a decision by the contracting officer. The contracting officer shall issue his decisions in writing, and shall mail or otherwise furnish a copy of the decision to the contractor. The decision shall state the reasons for the decision reached, and shall inform the contractor of his rights as provided in this Act. Specific findings of fact are not required, but, if made, shall not be binding in any subsequent proceeding. The authority of this subsection shall not extend to a claim or dis-

pute for penalties or forfeitures prescribed by statute or regulation which another federal agency is specifically authorized to administer, settle, or determine. This section shall not authorize any agency head to settle, compromise, pay, or otherwise adjust any claim involving fraud.

(b) The contracting officer's decision on the claim shall be final and conclusive and not subject to review by any forum, tribunal, or Government agency, unless an appeal or suit is timely commenced as authorized by this Act. Nothing in this Act shall prohibit executive agencies from including a clause in government contracts requiring that pending final decision of an appeal, action, or final settlement, a contractor shall proceed diligently with performance of the contract in accordance with the contracting officer's decision.

(c)(1) A contracting officer shall issue a decision on any submitted claim of $50,000 or less within sixty days from his receipt of a written request from the contractor that a decision be rendered within that period. For claims of more than $50,000, the contractor shall certify that the claim is made in good faith, that the supporting data are accurate and complete to the best of his knowledge and belief, and that the amount requested accurately reflects the contract adjustment for which the contractor believes the government is liable.

(2) A contracting officer shall, within sixty days of receipt of a submitted certified claim over $50,000—

(A) issue a decision; or

(B) notify the contractor of the time within which a decision will be issued.

(3) The decision of a contracting officer on submitted claims shall be issued within a reasonable time, in accordance with regulations promulgated

by the agency, taking into account such factors as the size and complexity of the claim and the adequacy of the information in support of the claim provided by the contractor.

(4) A contractor may request the agency board of contract appeals to direct a contracting officer to issue a decision in a specified period of time, as determined by the board, in the event of undue delay on the part of the contracting officer.

(5) Any failure by the contracting officer to issue a decision on a contract claim within the period required will be deemed to be a decision by the contracting officer denying the claim and will authorize the commencement of the appeal or suit on the claim as otherwise provided in this Act. However, in the event an appeal or suit is so commenced in the absence of a prior decision by the contracting officer, the tribunal concerned may, at its option, stay the proceedings to obtain a decision on the claim by the contracting officer.

(Nov. 1, 1978, P.L. 95-563, § 6, 92 Stat. 2384.)

§ 606. Contractor's right of appeal to board of contract appeals

Within ninety days from the date of receipt of a contracting officer's decision under section 6 [41 USCS § 605], the contractor may appeal such decision to an agency board of contract appeals, as provided in section 8 [41 USCS § 607].

(Nov. 1, 1978, P.L. 95-563, § 7, 92 Stat. 2385.)

§ 609. Actions in court: judicial review of board decisions

(a)(1) Except as provided in paragraph (2), and in lieu of appealing the decision of the contracting officer under section 6 [41 USCS § 605] to an agency board, a contractor may bring an action directly

on the claim in the United States claims Court, notwithstanding any contract provision, regulation, or rule of law to the contrary.

(2) In the case of an action against the Tennessee Valley Authority, the contractor may only bring an action directly on the claim in a United States district court pursuant to section 1337 of title 28, United States Code [28 USCS § 1337], notwithstanding any contract provision, regulation, or rule of law to the contrary.

(3) Any action under paragraph (1) or (2) shall be filed within twelve months from the date of the receipt by the contractor of the decision of the contracting officer concerning the claim, and shall proceed de novo in accordance with the rules of the appropriate court.

(b) In the event of an appeal by a contractor or the government from a decision of any agency board pursuant to section 8 [41 USCS § 607], notwithstanding any contract provision, regulation, or rules of law to the contrary, the decision of the agency board on any question of law shall not be final or conclusive, but the decision on any question of fact shall be final and conclusive and shall not be set aside unless the decision is fraudulent, or arbitrary, or capricious, or so grossly erroneous as to necessarily imply bad faith, or if such decision is not supported by substantial evidence.

(c) In any appeal by a contractor or the Government from a decision of an agency board pursuant to section 8 [41 USCS § 607], the court may render an opinion and judgment and remand the case for further action by the agency board or by the executive agency as appropriate, with such direction as the court considers just and proper.

(d) If two or more suits arising from one contract are filed in the United States Claims Court and one or more agency boards, for the convenience of parties of witnesses or in the interest of justice, the United States Claims Court may order the consolidation of such suits in that court or transfer any suits to or among the agency boards involved.

(e) In any suit filed pursuant to this Act involving two or more claims, counterclaims, crossclaims, or third-party claims, and where a portion of one such claim can be divided for purposes of decision or judgment, and in any such suit where multiple parties are involved, the court, whenever such action is appropriate, may enter a judgment as to one or more but fewer than all of the claims, portions thereof, or parties.

(Nov. 1, 1978, P.L. 95-563, § 10, 92 Stat. 2388; Apr. 2, 1982, P. L. 97-164, title I, Part B, §§ 157, 160(a)(15) in part, 161(10), 96 Stat. 47-49.)

APPENDIX F

MILLER ACT

40 U.S.C. §270a. Bonds of contractors for public buildings or works; waiver of bonds covering contract performed in foreign country

(a) Before any contract, exceeding $2,000 in amount, for the construction, alteration, or repair of any public building or public work of the United States is awarded to any person, such person shall furnish to the United States the following bonds, which shall become binding upon the award of the contract to such person, who is hereinafter designated as "contractor":

(1) A performance bond with a surety or sureties satisfactory to the officer awarding such contract, and in such amount as he shall deem adequate, for the protection of the United States.

(2) A payment bond with a surety or sureties satisfactory to such officer for the protection of all persons supplying labor and material in the prosecution of the work provided for in said contract for the use of each such person. Whenever the total amount payable by the terms of the contract shall be not more than $1,000,000 the said payment bond shall be in a sum of one-half the total amount payable by the terms of the contract. Whenever the total amount payable by the terms of the contract shall be more than $1,000,000 and not more than $5,000,000, the said payment bond shall be in a sum of 40 per centum of the total amount payable by the terms of the contract. Whenever the total amount payable by the terms of the contract shall

be more than $5,000,000 the said payment bond shall be in the sum of $2,500,000.

(b) The contract officer in respect of any contract is authorized to waive the requirement of a performance bond and payment bond for so much of the work under such contract as is to be performed in a foreign country if he finds that it is impracticable for the contractor to furnish such bonds.

(c) Nothing in this section shall be construed to limit the authority of any contracting officer to require a performance bond or other security in addition to those of in cases other than the cases specified in subsection (a) of this section.

(d) Every performance bond required under this section shall specifically provide coverage for taxes imposed by the United States which are collected, deducted, or withheld from wages by the contractor in carrying out the contract with respect to which such bond is furnished. However, the United States shall give the surety or sureties on such bond written notice, with respect to any such unpaid taxes attributable to any period, within ninety days after the date when such contractor files a return for such period, except that no such notice shall be given more than one hundred and eighty days from the date when a return for the period was required to be filed under the Internal Revenue Code of 1954 [26 USCS § 1 et seq.] No suit on such bond for such taxes shall be commenced by the United States unless notice is given as provided in the preceding sentence, and no such suit shall be commenced after the expiration of one year after the day on which such notice is given.

(Aug. 24, 1935, c . 642, § 1, 49 Stat, 693; Nov. 2, 1966, P. L. 89-719, Title I, § 105(b), 80 Stat. 1139.)

APPENDIX G

Text of Miller Act Bond

KNOW ALL MEN BY THESE PRESENTS. That we, the Principal and Surety(ies) hereto, are firmly bound to the United States of america (hereinafter called the Government) in the above penal sum for the payment of which bind ourselves, our heirs, executors, administrators, and successors, jointly and severally: *Provided* That, where Sureties are corporations acting as co-sureties, we, the Sureties, bind ourselves in such sum "jointly and severally" well as "severally" only for the purpose of allowing a joint action or actions against any or all of us, and for a other purposes each Surety binds itself, jointly and severally with the Principal, for the payment of such sum only is set forth opposite the name of such surety, but if no limit of liability is indicated, the limit of liability shall be full amount of the penal sum.

THE CONDITION OF THIS OBLIGATION IS SUCH, that whereas the Principal entered into the contract identification above;

NOW, THEREFORE, if the Principal shall:

(a) Perform and fulfill all the undertakings, covenants, terms, conditions, and agreements of said contract during the original term of said contract and any extensions thereof that may be granted by the Government, with or without notice to the Surety(ies), and during the life of any guaranty required under the contract, and shall also perform an fulfill all the undertakings, covenants, terms, conditions, and agreements of any and all duly authorized modification of said contract that may hereafter be made,

notice of which modifications to the Surety(ies) being hereby waived; an

(b) If the said contract is subject to the Miller Act, as amended (40 U.S.C. 270a-270e), pay to the Government the full amount of the taxes imposed by the Government which are collected, deducted, or withheld from wages paid by the Principal is carrying out the construction contract with respect to which this bond is furnished; then the above obligation shall be void and of no effect.

IN WITNESS WHEREOF, the Principal and Surety(ies) have executed this performance bond and have affixed their seals on the date set forth above.

APPENDIX H

Disputes Clause of Morton Contract

6. DISPUTES

(a) Except as otherwise provided in this contract, any dispute concerning a question of fact arising under this contract which is not disposed of by agreement shall be decided by the Contracting Officer, who shall reduce his decision to writing and mail or otherwise furnish a copy thereof to the Contractor. The decision of the Contracting Officer shall be final and conclusive unless, within 30 days from the date of receipt of such copy, the Contractor mails or otherwise furnishes to the Contracting Officer a written appeal addressed to the head of the agency involved. The decision of the head of the agency or his duly authorized representative for the determination of such appeals shall be final and conclusive. This provision shall not be pleaded in any suit involving a question of fact arising under this contract as limiting judicial review of any such decision to cases where fraud by such official or his representative or board is alleged; *Provided, however,* That any such decision shall be final and conclusive unless the same is fraudulent or capricious or arbitrary or so grossly erroneous as necessarily to imply bad faith or is not supported by substantial evidence. In connection with any appeal proceeding under this clause, the Contractor shall be afforded an opportunity to be heard and to offer evidence in support of his appeal. Pending final decision of a dispute hereunder, the contractor shall proceed diligently with the performance of the contract and in accordance with the Contracting Officer's decision.

(b) This Disputes clause does not preclude consideration of questions of law in connection with decisions provided for in paragraph (a) above. Nothing in this contract, however, shall be construed as making final the decision of any administrative official, representative, or board on a question of law.

APPENDIX I

Contracting Officer's Final Decision

United States Department of Agriculture Office of General Counsel
Washington, D.C. 20250

CERTIFIED MAIL-RETURN RECEIPT REQUESTED

William Thompson, Esquire
Hudson, Creyke, Koehler and Tacke
1101 King Street
Suite 500
Alexandria, Virginia 22314

Dear Mr. Thompson:

Subject: *United States* v. *Seaboard Surety Co. Inc., et al.*, Eastern District of New York No. CV-82-0518

Enclosed please find a copy of the Contracting Officer's Final Decision asserting the Government's claim for damages against the Joseph Morton Company, Inc., and its sureties arising out of Contract No. 12-14-0605-192. Copies of this Final Decision were mailed to both Seaboard Surety Company and Home Insurance Company.

Sincerely,

DANIEL W. WENTZELL, Attorney
Research and Operations Division
Enclosure

CONTRACTING OFFICER'S DECISION

This is the decision of the Contracting Officer pursuant to Clause 6 "Disputes" of the General Provisions, Standard Form 23-A of the contract on a dispute between the contractor, Joseph Morton Company, present address unknown, and the Contracting Officer arising out of the Contract No. 12-14-0605-192, dated September 24, 1976.

Contract No. 12-14-0605-192 was for the construction of a warehouse and additions to existing laboratories at the Plum Island Animal Disease Center, Plum Island, New York. The contract was awarded to the Morton Company by the Agricultural Research Service, (subsequently reorganized into the Science and Education Administration), United States Department of Agriculture, in the amount of $10,049,000.00 (subsequently increased to $10,689,000.00 by the inclusion of Add Alternative No. 1).

Seaboard Surety Company, 90 William Street, New York, New York, and, its then parent company, Home Insurance Company, 59 Maiden Lane, New York, New York, jointly issued a Performance Bond in the amount of $10,049,000.00. Seaboard Surety Company had a limit of liability of $3,300,000.00, with the remaining $6,749,000.00 being assumed by Home Insurance Company on the initial performance bond. In accordance with the above stated exercise of Add Alternative No. 1, the total amount of the penal sum was subsequently increased to $10,689,000.00 by an endorsement executed February 2, 1977.

CONTRACTING OFFICER'S CLAIM AGAINST THE CONTRACTOR AND THE SURETIES

The Contracting Officer is making this claim against the contractor and its sureties for damages incurred by the Government in excess of the amount of funds remaining under the contract, including retainage held, after the termination of the contractor's right to proceed. The contractor was terminated for default by notices issued March 5 and 28, 1979. Following the termination for default the Government tendered the job to the sureties for the Morton Company under a Surety-Takover-Agreement; however, the sureties declined to takeover and complete the work.

As detailed in the "Expert's Preliminary Report" dated November 22, 1985, prepared by the Government's Construction Manager, Lasker Goldman Corporation/Goldman Associates, Section 1, Schedule A-1, and associated sections, the Government has been damaged in the amount of $17,064,951.00 in regard to Contract No. 12-14-0605-192. At the time of the termination for default and the sureties declination to takeover the project there remained a balance of $2,569,268.67, including contract retainage, left in the funds obligated to Contract No. 12-14-0605-192. Accordingly, after taking account of the contract balance there remains the sum of $14,495.682.00 in damages for which the Morton Company and its sureties are jointly and severally liable in accordance with Clause 5, "Termination For Default-Damages For Delay-Time Extension's" of the General Provisions of the contract.

DECISION

It is the decision of the Contracting Officer that payment to the United States of America in the

amount of $14,495,682.00 shall be due and payable by the Joseph Morton company, Inc. and/or its sureties, Seaboard Surety Company and Home Insurance Company upon receipt of this decision. In addition to the above set forth amount, the Government reserves to itself all other rights and remedies existing at law. Unless payment is received within 30 days after receipt of this decision, interest will accrue at the annual effective rate set by the United States Treasury.

In accordance with the election made by the Morton Company before the United States Claims Court in *Joseph Morton Company, Inc. v. United States,* U.S. Claims Court No. 107-82C, (copy attached) the Contracting Officer is on notice that the Morton Company has determined that any claims asserted by the Government in regard to Contract No. 12-14-0605-192 will be appealable under the provisions of the Contract Disputes Act of 1978 (41 U.S.C. 601, *et seq.*). Accordingly, you are hereby advised that this decision may be appealed by the contractor to the Agriculture Board of Contract Appeals. If the contractor decides to make such an appeal he must mail or otherwise furnish written notice thereof to the Board of Contract Appeals, U.S. Department of Agriculture, Washington, D.C. 20250, within 90 days of the date he receives this decision. A copy thereof shall be furnished to the Contracting Officer from whose decision the appeal is taken. The notice shall indicate that an appeal is intended, should reference this decision and identify the contract by number. In lieu of appealing to the Agriculture Board of Contract Appeals, the contractor may bring an action in the U.S. Court of Claims, within 12 months of the date he receives this decision.

Raymond N. Stickles
Contracting Officer
Agricultural Research Service
U.S. Department of Agriculture
1/6/86
Date

SCHEDULE A-1

Calculation of costs Attributable to Defendant

Amount Expended to Correct Deviations and Non-Compliances	3,577,982.00
Amount Expended to Complete Contract Requirements	2,900,361.00
Estimated Cost of Corrective Work Postponed or Omitted Partially Verified	2,932,421.00
Estimated Cost of Work to Complete Morton Contract	3,547,508.00
Requirements Postponed or Omitted	
Proportionate cost of Assessment, Refunding,	4,092,588.00
Reprocurement, Architecture and Engineering, Construction Management and General Conditions	14,091.00
Total Cost Attributable to Defendant	$17,064,951.00

87-223

Supreme Court, U.S.
FILED
JUL 31 1987
JOSEPH F. SPANIOL, JR.
CLERK

No. 87-

IN THE

Supreme Court of the United States

OCTOBER TERM, 1987

SEABOARD SURETY COMPANY
and
THE HOME INSURANCE COMPANY
Petitioners,

v.

UNITED STATES OF AMERICA
Respondent.

SUPPLEMENTAL APPENDIX TO PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

WILLIAM W. THOMPSON, JR.
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Alexandria, VA 22314

July 31, 1987

PRESS OF BYRON S. ADAMS, WASHINGTON, D.C. (202) 347-8203

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APPENDIX J

United States District Court,
E.D. New York

No. CV 82-0518

UNITED STATES of America,
Plaintiff,
SEABOARD SURETY COMPANY and
the Home Insurance Company,
Defendant and Third-Party Defendants.
v.
JOSEPH MORTON CO., INC., Joseph J. Battaglia and
the Perkins & Will Partnership,
Third-Party Defendants.

United States brought action against public contract performance bond sureties under Miller Act. The United States moved for partial summary judgment, and sureties moved for dismissal and for summary judgment. The District Court, Wexler, J., held that: (1) prior judgments could not be basis for holding sureties liable on performance bond, and (2) Contract Disputes Act was not applicable.

Order accordingly.

Raymond J. Dearie, U.S. Atty. by Thomas Roberts, Asst. U.S. Atty., Brooklyn, N.Y., for plaintiff.

Hart & Hume, New York City, for defendants/third party plaintiffs.

Bernstein, Weiss, Copland, New York City, for third party defendants Perkins & Will.

MEMORANDUM AND ORDER

WEXLER, District Judge.

I.

In September 1976 Joseph Morton Company (Morton), then headed by Joseph Battaglia, was awarded a building contract by the United States government to construct additions to the Plum Island Animal Disease Center on Long Island, New York. Seaboard Surety Company and The Home Insurance Company (the Sureties) issued the performance bond. During the ensuing three years hundreds of modifications were ordered. In March 1979 Morton by letter declared the United States in breach of contract. The United States immediately notified Morton that it was terminated for default, specifically for non-performance. The United States then looked to the Sureties for completion of the project. The Sureties refused to either complete the project or pay the performance bond.

In march 1980 Morton filed for Chapter 11 Reorganization under the Bankruptcy Code. Pursuant to 11 U.S.C. § 302(c)(2)(B), all persons were stayed from filing any action against Morton without the leave of the Bankruptcy Court during pendency of the bankruptcy action. In March 1982 Morton filed suit in the United States Claim Court seeking to have the termination for convenience. Termination for convenience would allow Morton to recover costs plus some profit on the work performed before termination. Unfortunately, in 1980 the United States charged Morton with fraud and conspiracy to commit fraud in connection with Change Order No. 2 of the Plum Island contract. The company was convicted of sub-

mitting false and fraudulent cost statements in violation of 18 M.S.C. §§ 2, 371, 1001, and 3237 in April 1981.[1]

In response to Morton's 1982 suit in the Claims Court for a ruling of termination for convenience, the United States asked for summary judgment sustaining the default termination. In July 1983 the Claims Court issued a decision. Neatly avoiding the issue of non-performance, the Claims Court upheld the termination for default based on the post-termination charge and conviction of fraud. The Claims Court declared that even though the United States did not know of the fraudulent cost statements in March 1979 and did not terminate the contract for that reason, the fraud had been committed before termination and could have been, had it been discovered, a basis for default termination. Accordingly, since fraud could have been the ground for default termination, the Claims Court sustained the default termination of the entire contract without deciding the non-performance issue. *Joseph Morton Co. v. United States,* 3 Cl.Ct. 120, 122 (1983). On appeal the United States Court of Appeals for the Federal Circuit affirmed the Claims Court, holding that newly-discovered grounds can support a prior termination for default. *Joseph Morton Co. v. United States,* 757 F.2d 1273, 1277-79 (Fed.Cir.1985).

In 1982, at the same time Morton commenced its suit in the Claims Court, the United States commenced the instant action against the Sureties under the Miller Act. 40 U.S.C. §§ 270a.-d. The simultaneous

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[1] *United States v. Joseph Morton Co.,* No. CR 80-00413 (E.D.N.Y. April 24, 1981), *aff'd* Nos. 81-1174/1233 (2d Cir. Jan. 11, 1982).

suits were filed by agreement. Moreover, it appears that the Sureties were acting for Morton in the Claims Court, that is, they paid the lawyer and generally directed the litigation. In any event, in April 1983 the United States Bankruptcy Court dismissed Morton's Chapter 11 proceeding. Morton was not discharged and the automatic stay was lifted. At this point, the United States sought to enter counterclaims for breach of contract against Morton in the Claims Court action.

Morton opposed adding the counterclaims on the basis of the recently enacted § 6(a) of the Contract Disputes Act of 1978 (CDA), 41 U.S.C. § 605(a). Under the CDA "[a]ll claims by the government against a contractor relating to a contract shall be the subject of a decision by the contracting officer." There was some question as to whether § 6(a) of the CDA applied to Morton, as its contract pre-dated the Act, and might or might not be grandfathered in under the footnote to § 16, 41 U.S.C. § 601. Despite a First Circuit Court of Appeals opinion holding that a decision by a contracting officer was not necessary in a similar case, *Woods Hole Oceanographic Institution v. United States,* 677 F.2d 149 (1st Cir.1982), the Claims Court held that under §§ 6(a) and 16 of the CDA,Morton could choose to invoke the requirements of the Act. If Morton so chose there must be a decision from a contracting officer before the government could file and pursue its counterclaims in the Claims Court action. Morton opted to proceed under the CDA. The government appealed and the Federal Circuit affirmed the Claims Court, holding that the CDA does apply and the contracting officer's decision is a jurisdictional prerequisite to the government's

claims against Morton. *Joseph Morton Co. v. United States,* 757 F.2d 1273 (Fed.Cir. 1985).

Plaintiff United States now moves for partial summary judgment in its favor, Rule 56(b), Fed.R.Civ.P., holding that the Claims Court decision sustaining termination for default works collateral estoppel on the issue of the Sureties' liability. The government argues that as it is now settled that Morton defaulted on the contract, the Sureties' liability on the bond is established and only damage issues remain for trial. The Sureties oppose partial summary judgment, maintaining that they are not collaterally estopped by the Claims Court judgment from contesting liability. The Sureties also move for dismissal of this action on the ground that under the CDA a decision by a contracting officer is a jurisdictional prerequisite to commencing and maintaining this suit, and that the Court of Claims then has exclusive jurisdiction. 41 U.S.C. §§ 605, 609. The government counters that the CDA is applicable to contractors but not their Sureties. In addition, the Sureties move for summary judgment in their favor holding that under the circumstances it was impossible for Morton to perform the construction contract or that changes in the contract during the course of construction amounted to breach or recession releasing Morton from performance. The various motions were submitted in two sets of motion some months apart. In the interest of efficiency the Court chooses to address and decide them in one opinion.

II.

The Court first addresses the issue of collateral estoppel. Collateral estoppel is a more limited and

narrow application of its sister doctrine, *res judicata*. Both serve the goals of judicial finality, legal certitude, and judicial economy. *E.g., Commissioner of Internal Revenue v. Sunnen*, 333 U.S. 591, 597, 68 S.Ct. 715, 719, 92 L.Ed. 898 (1948). The doctrine of *res judicata* holds that once a case has been litigated to judgment it should not be the subject of repeated suits. Rather, the first judgment disposes of any subsequent suits involving the same factual events and legal issues among the same parties or their privities. Of course, application of *res judicata* frequently raises questions of identity, privity, and what issues and claims were the subject of final judgment.

Collateral estoppel is a narrower application of *res judicata*. Where a second lawsuit between the same parties, or those who stand in their place, involves a different cause of action, the judgment in the first action estops relitigation of only those matters that were litigated and the subject of a final determination or verdict. *Id.* at 598, 68 S.Ct. at 719. In other words, the effect of the prior judgment is limited to specific issues in the second action and does not dispose of the entire suit.

In the instant case, the government asks that this Court apply the judgment of the Claims Court upholding contract termination for default to dispose of the liability issue between the government and the Sureties. More accurately, the government asks that Morton's criminal conviction for fraud operate as an estoppel on the issue of the Sureties' liability on the performance bond.

It is not disputed that there is sufficient identity of interest between the parties on each side of the two cases. Neither party here seriously disputes that

there was sufficient opportunity to litigate the questions of fraud and termination in the earlier action. What is in question is what the earlier judgment decided and the effect it should have here.

The Court will not indulge in long discussion. The application the government advocates is overly broad. Collateral estoppel requires a narrow application. The judgment in the criminal case was that Morton had committed fraud in certain cost and payment statements submitted to the government. The judgment in the Claims Court case was that Morton defaulted on the contract by committing that fraud. Neither judgment addresses the issues of contract performance. Whether Morton performed construction of the Plum Island addition as it should have, whether the architect's construction plans were faulty, and other performance issues have not yet been litigated or decided by any court. These contract performance issues are the essence of the government's claims and the Sureties' defenses. As the Sureties point out, they issued a performance bond, nota fidelity bond. They were liable for failure to properly build the facility addition, not for fraudulent Change Orders.

Accordingly, the judgment of the district court that tried the criminal case and the judgment of the Claims Court, which was affirmed by the Federal Circuit, operates as collateral estoppel on the issues of the specific fraudulent acts committed by Morton, and its agents, and the default termination for those fraudulent acts. The Court concludes that as neither judgment had any bearing on the contract performance issues, they cannot be the basis for holding the Sureties liable on the performance bond. Plaintiff's mo-

tion for partial summary judgment, therefore, is denied.

III.

The Court next addresses the more difficult issue of application of the CDA to the case at bar. 41 U.S.C. §§ 601 to 613. Specifically, the Sureties contend that as this suit involves the question of performance of a contract with the government, at the non-government party's opinion it must first be the subject of a contracting officer's decision, and in any event, can only be heard by the Claims Court. Defendant Sureties ask for dismissal on this ground. The government maintains that only a contractor can assert these defenses, not its surety. Moreover, plaintiff contends the CDA is not applicable to this action.

The issue appears to be one of first impression. While the parties contest at some length the law regarding when a surety can assert defenses or claims of a contractor, the Court is convinced that this is not the correct analysis. Rather, the dispositive question is whether the CDA applies to actions between the government and sureties.

The CDA is silent as to its application to sureties and the Miller Act, 40 U.S.C. § 2709a.-d. The Miller Act requires that a contractor for a public building secure a payment and a performance bound in conformance with the statute. The government here sues the Sureties on the performance bond pursuant to the Miller Act. the CDA goes no further than declaring that its provisions apply to disputes involving contracts to which the United States is a party and where the contract is for, among other things, "the pro-

curement of construction . . . [on] real property." 41 U.S.C. § 602(a)(3). Throughout its provisions the statute speaks of disputes between contractors and the government. A "contractor"s is defined as "a party to a Government contract other than the Government." 41 U.S.C. § 601(4). The question is, then, does the CDA by its intent or definition apply to actions involving sureties.

The Court is unwilling to construe the terms of the CDA beyond the plain meaning of its words. A contractor is a party to a government contract, and this a surety is not. Obviously, a surety has an interest in the contract, but unless the contractor defaults, the surety is not directly involved. This construction is supported by a reading of the legislative history. Among the declared purposes of the CDA is the equalization of the bargaining power of the parties and the assurance of fair and equitable treatment of contractors. S.Rep. No. 95-1118, 95th Cong., 2d Sess. 1, *reprinted in* 1978 U.S.Code Cong. & Ad.News 5235. The legislation addressed particular concern not only that the resolution of contract disputes should be uniform throughout the government with greater opportunity for negotiated settlement, but that small contractors should not be at an economic disadvantage and their right to due process should be safeguarded. *Id.* at 4, *reprinted in* 1978 U.S.Code Cong. & Ad.News at 5238.

The legislative history, however, does not speak directly to the Miller Act or the CDA's application to sureties. Rather, its primary concern is clearly contractors' claims. Nevertheless, the legislative history and the statute do directly address the CDA's affect on a number of other statutes. 41 U.S.C. §§ 602(b-

c), 603, and 609(a); S.Rep. No. 95-1118 at 33-35, *reprinted in* 1978 U.S.Code Cong. & Ad. News at 5267-69. Faced with this silence on the subject of the Miller Act and sureties amid discussion and provision for effects on other areas of the law, the Court concludes that congress did not contemplate or intend application of the CDA to include the Miller Act and suits between sureties and the government. Where Congress has set out to crate a coherent system, the Court will infer that what Congress did not include it meant to exclude. In other words, the Court refuses to construe the CDA so broadly as to include what Congress gives not the slightest suggestion it intended to include. Accordingly, the court holds that the CDA is not applicable to the government's action against the Sureties under the Miller Act.

Nor is the Court particularly enlightened by the parties' discussion of subrogation. While discussing an earlier motion by the third-party defendant Perkins & Will Partnership for dismissal of the action against them, the Court noted that it doubted that the Sureties are subrogated to the rights of the contractor, but more likely are subrogated to the rights of the government. Slip op. at 8 (E.D.N.Y. September 10, 1985). A brief perusal of the issue of surety subrogation under the Miller Act has not convinced the Court that the result under that statute is any different.

Furthermore, the Court is not convinced that a contracting officer's decision would make any difference in the course of this litigation, save to delay it. The government undertook detailed review of the Plum Island construction immediately after the default and Sureties' refusal to complete the project. Based on

the parties' litigation preparation, the Court sees no likelihood that a decision by a contracting officer will finally resolve the case or that proceedings before the officer will result in a negotiated settlement. proceedings in this action have already extended over a three-year period without any indication that the matter can be ended short of trial. Nor does the Court find any indication that Congress intended to remove actions under the Miller Act from the jurisdiction of the district courts.

IV.

Lastly, it appears that the Sureties are asking for summary judgment in their favor holding that performance of the construction contract was impossible and that the numerous change orders included or amounted to a "cardinal change" in the contract. These are clearly disputed issues of material fact requiring trial, and summary judgment must be denied.

V.

The Court determines that the earlier decisions by the district court and the Claims Court on the issue of Morton's fraudulent Change Orders and termination for default based on fraud operate to collaterally estop litigation of those limited issues before this Court. All other motions by the plaintiff and defendant Sureties are denied.

SO ORDERED.

APPENDIX K

UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF NEW YORK

Memorandum and order
CV 82-0518
(Wexler, J.)

UNITED STATES OF AMERICA,

Plaintiff,

-against-

SEABOARD SURETY COMPANY and
THE HOME INSURANCE COMPANY,

Defendants.

APPEARANCES:

REENA RAGGI, UNITED STATES ATTORNEY
BY: THOMAS ROBERTS, ASSISTANT U.S. ATTORNEY
Attorney for Plaintiff
United States District Court
225 Cadman Plaza East
Brooklyn, New York 11201

HART & HUME, ESQS.
Attorneys for Defendants
10 East 40th Street
New York, New York 10016

WEXLER, District Judge

On May 21, 1986, a jury entered a verdict awarding to the United states the sum of $10,631,626 in the above-captioned matter. It was decided during the course of the action that the Court should reserve for itself the issue of prejudgment interest. This issue must now be resolved.

It has long been settled that the United States is entitled to recover prejudgment interest. This issue must now be resolved.

It has long been settled that the United States is entitled to recover prejudgment interest on its claims, and, as both parties acknowledge, in the absence of a controlling statute or regulation, the determination of the appropriate rate and period of interest is within the sound discretion of the district court. *Royal Indemnity v. United states,* 313 U.S. 289, 61 S.Ct. 995 (1941); *United States v. Seaboard Surety Co.,* 339 F.2d 1 (2d Cir. 1964). The Court finds that no statute or regulation controls the case at bar and, therefore, the imposition of prejudgment interest lies within the Court's discretion.

On May 30, 1980, defendants sent Calvin Persinger, the United States Contracting Officer, a letter repudiating any liability under the performance bond. Accordingly, the Court holds that the imposition of prejudgment interest from this date is appropriate. *Cf. Seaboard Surety,* 339 F.2d 1 (government entitled to have interest computed from time that demands first made on surety's principal).

The Court must next determine the appropriate rate of interest. Considering the circumstances presented by this case, the Court finds that prejudgment interest equal to the discount rate available as of May 30 of each year for which the defendants were in breach should be awarded. The discount rate as of this date for the years 1980 through 1986 was the following:

YEAR	RATE
1980	12%
1981	14%
1982	12%
1983	8.5%
1984	9%
1985	7.5%
1986	6.5%

It might be noted that the Second Circuit has upheld the award of prejudgment interest to be paid at the adjusted prime rate, *Equal Employment Opportunity Commission v. County of Erie,* 751 F.2d 79 (2d Cir. 1984), which is higher than the discount rate,[1] and has held that a plaintiff may recover prejudgment interest as measured by the interest on short term, risk free obligations. *Independent Bulk Transport v. Vessel "Morania Abaco",* 676 F.2d 23 (2d Cir. 1982). Furthermore, the Second Circuit has affirmed an award of 12% prejudgment interest, *id.*, a rate higher than or equal to the discount rate for all but one of the dates relevant to the case at bar. It should also be observed that the United States is subject to prejudgment interest in the amount of 12.25% on any construction contracts upon which it may be liable for

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[1]The prime rate for the dates relevant to this decision were:

YEAR	RATE
1980	14%
1981	20%
1982	16%
1983	10.5%
1984	12.5%
1985	10%
1986	8.5%

breaches on the May 30, 1980 date. 41 U.S.C. § 611; 45 Fed. Reg. 2456 (January 11, 1980).

In light of these factors, and the circumstances presented by the case, the Court in its discretion holds that an award of yearly prejudgment interest as measured by the discount rate as of May 30 of each year beginning May 30, 1980 is warranted.

Accordingly, it is hereby ORDERED that prejudgment interest shall be awarded as follows:

(a) Prejudgment interest is to be awarded beginning May 30, 1980.

(b) All interest shall be simple interest.

(c) For the year commencing May 30, 1980, interest shall be at the rate of 12%; for the year commencing May 30, 1981, interest shall be at the rate of 14%; for the year commencing May 30, 1982, interest shall be at the rate of 12%; for the year commencing May 30, 1983, interest shall be at the rate of 8.5%; for the year commencing May 30, 1984, interest shall be at the rate of 9%; for the year commencing May 30, 1985, interest shall be at the rate of 7.5% for the period commencing May 30, 1986 and continuing until the entry of judgment, interest shall be at the rate of 6.5%. Additionally, the Clerk of the Court is directed to assess any post judgment interest in accordance with 28 U.S.C. § 1961.

SO ORDERED.
LEONARD D. WEXLER
UNITED STATES DISTRICT JUDGE

Dated: Uniondale, New York
June 25, 1986

APPENDIX L

UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF NEW YORK

UNITED STATES OF AMERICA,
Plaintiff,

- against -

SEABOARD SURETY COMPANY and
THE HOME INSURANCE COMPANY,
Defendants.

Received JUL 3 1986 Filed Jun 30, 1986

JUDGMENT

The action having been tried by jury, and the jury having rendered its verdict on May 21, 1986 in favor of plaintiff and against defendants in the amount of $10,631,326.00, and a memorandum and order of Honorable Leonard D. Wexler, United States District Judge, having been filed on June 25, 1986, awarding prejudgment simple interest at the rate of 12% for the year commencing May 30, 1980, 14% for the year commencing May 30, 1981, 12% for the year commencing May 30, 1982, 8.5% for the year commencing May 30, 1983, 9% for the year commencing May 30, 1984, 7.5% for year commencing May 30, 1985, and 6.5% for the year commencing May 30, 1986, and post judgment interest in accordance with 28 U.S.C. Sec. 1961 at the rate of 7.03%, it is

ORDERED and ADJUDGED that judgment is entered in favor of the United States of America, plaintiff, and against Seaboard Surety Company and the Home Insurance Company, defendants, in the amount of $10,631,326.00, plus simple interest at the

rate of 12% for the year commencing May 30, 1980 in the sum of $1,275,759.12, at the rat of 14% for the year commencing May 30, 1981 in the sum of $1,488,385.64, at the rate of 12% for the year commencing May 30, 1982 in the sum of $1,275,759.12, at the rate of 8.5% for the year commencing May 30, 1983 in the sum of $903,662.71, at the rate of 9% for the year commencing May 30, 1984 in the sum of $956,819.34, at the rate of 7.5% for the year commencing May 30, 1985 in the sum of $797,349.45, at the rate of 6.5% for the period commencing May 30, 1986 through June 30, 1986 in the sum of $57,586.35 for a total judgment of $17,386,647.73; and that the rate of any post-judgment interest in 7.03% in accordance with 28 U.S.C., Sec. 1961.

Dated: Uniondale, New York
June 30, 1986

Approved:

/s/Leonard D. Wexler
LEONARD D. WEXLER
UNITED STATES DISTRICT judge

JUDGMENT ENTLRED:

ROBERT C. HEINEMANN
Clerk of Court

BY: /s/Joseph DiTalia
Joseph DiTalia
Deputy Clerk-in-Charge

Supreme Court, U.S.
FILED
SEP 9 1987
JOSEPH F. SPANIOL, JR.
CLERK

No. 87-223

In the Supreme Court of the United States

OCTOBER TERM, 1987

SEABOARD SURETY COMPANY, ET AL., PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

CHARLES FRIED
Solicitor General
Department of Justice
Washington, D.C. 20530
(202) 633-2217

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In the Supreme Court of the United States

OCTOBER TERM, 1987

No. 87-223

SEABOARD SURETY COMPANY, ET AL., PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

Petitioners are sureties for a contractor who defaulted on a federal construction project. When petitioners denied liability under the performance bonds they had executed, the government successfully sued them in federal district court. Petitioners now challenge the jurisdiction of the district court, contending that under the Contract Disputes Act of 1978 (CDA), 41 U.S.C. (& Supp. III) 601 *et seq.*, only the Claims Court had jurisdiction to entertain the government's suit.

1. In the early 1970's, the Department of Agriculture decided to expand its Plum Island Animal Disease Center. The low bid for the construction project was submitted by The Joseph Morton Company (Morton), which was awarded the contract on September 24, 1976. Pet. App. 3a-4a. As required by the Miller Act, 40 U.S.C. (& Supp. III) 270a *et seq.*, Morton obtained a performance bond, which obligated petitioners as sureties to complete the project or pay the government its costs of completion if Morton was terminated for default. Pet. App. 5a, 62a-63a. The government was not a party to the bond. Pet. App. 9a.

Faced from the outset with problems including defective construction, poor maintenance, and undue delays, the government finally terminated Morton for default on March 1, 1979. Pet. App. 4a. The government then asked petitioners to complete the project. They declined, asserting in a letter of May 30, 1980, that Morton's termination for default was improper and that the government had breached the contract. Pet. App. 5a.[1] The government finally engaged another contractor, which was able to complete 60% of the project at an additional cost of approximately $11,400,000. Pet. App. 5a-6a, 17a.

On March 1, 1982, the government filed the present action against petitioners in the United States District Court for the Eastern District of New York.[2]

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[1] Petitioners did offer to complete the project using Morton, an offer which, as the court of appeals put it, "the government understandably rejected." Pet. App. 5a.

[2] There have been several related proceedings. In a criminal action, Morton was convicted of conspiracy to defraud the United States, knowingly submitting false and fraudulent cost statements, and obstructing justice. *United States* v. *Joseph Morton Co.*, No. CR-80-413 (E.D.N.Y. Apr. 24, 1981),

Petitioners thereafter moved to dismiss for lack of jurisdiction, claiming that the CDA vests exclusive jurisdiction over the case in the Claims Court. The district court denied the motion (Pet. Supp. App. 1a-11a). It explained (Pet. Supp. App. 9a) that the CDA governs "disputes between contractors and the government" and noted that while "[a] contractor is a party to a government contract, * * * a surety is not." Reviewing the legislative history of the Act, the court found (*id.* at 10a) "that Congress did not contemplate or intend application of the CDA to include the Miller Act and suits between sureties and the government." The district court accordingly "refuse[d] to construe the CDA so broadly as to include what Congress g[a]ve[] not the slightest suggestion it intended to include" (*ibid.*).

After a two-week trial, the jury returned a verdict against petitioners and awarded the United States $10,631,326.00. Pet. App. 8a. To this sum the district court added $6,755,321.73 in prejudgment interest, calculated from May 30, 1980, the date on which petitioners denied liability under the bond. *Ibid.*

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aff'd, No. 81-1174/1233 (2d Cir. Jan. 11, 1982). Morton filed its own lawsuit in the former Court of Claims, alleging that the government had breached the contract. The Claims Court dismissed Morton's petition and held that Morton's fraudulent conduct justified the government in terminating the contract. *Joseph Morton Co.* v. *United States*, 3 Cl. Ct. 120 (1983). The Court of Appeals for the Federal Circuit affirmed. *Joseph Morton Co.* v. *United States*, 757 F.2d 1273 (Pet. App. 25a-42a). Finally, in January, 1986, the contracting officer on the Plum Island project determined that Morton and petitioners were liable for $14,495,682.00 in damages due to Morton's breach of contract (Pet. App. 66a-70a); their appeal to the Claims Court is pending. *Joseph Morton Co.* v. *United States*, No. 48-86C (Cl. Ct.).

2. The court of appeals affirmed in part, reversed in part, and remanded (Pet. App. 1a-22a). It had "little difficulty" rejecting (*id.* at 9a-10a) petitioners' contention that sureties are "contractors" within the meaning of the CDA and thus that the district court lacked jurisdiction. The court explained (*id.* at 9a) that the CDA applies only to "contract[s] to which the government is a party" and noted that the government was only "a third-party beneficiary, not * * * a party" to the bond between Morton and petitioners. The court also rejected the contention that petitioners should nevertheless be treated as contractors under the CDA because their liability is "derivative from Morton's liability" (*id.* at 10a). "It does not follow * * * that the derivative nature of a surety's liability places it in its principal's shoes for purposes of vesting exclusive jurisdiction in the claims court. * * * Since the liability of a surety is distinct from that of its principal, there is no compelling reason to conclude that a claim by the government against a surety must be tried in the claims court simply because claims against the principal must be heard there under the terms of the CDA." [3]

3. Under 28 U.S.C. 1345, federal district courts have jurisdiction over all cases brought by the United States, "[e]xcept as otherwise provided by Act of

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[3] In addition to its ruling on the jurisdictional question, the court of appeals held that the district court should not have admitted at trial evidence of petitioners' bad faith. The court found that error to be harmless, however. Pet. App. 12a-19a. The court of appeals also held that the district court had abused its discretion in awarding interest from May 30, 1980, and remanded the case for a revised calculation of the prejudgment interest. *Id.* at 19a-22a. The petition does not present these issues.

Congress." [4] Petitioners contend, in essence, that this case falls within the exception to Section 1345, on the ground that the CDA vests exclusive jurisdiction in the Claims Court over suits brought by the United States against Miller Act sureties.

The decision below was correct. The CDA by its terms creates no exception to 28 U.S.C. 1345 for suits by the government—against either contractors or sureties. There is simply no language in the CDA that requires—or even permits—the United States to commence an action in the Claims Court.

Moreover, even if the Act could plausibly be read to require the government to resort to the Claims Court when it sues a "contractor" under an "express or implied contract * * * entered into by an executive agency" (41 U.S.C. 602(a)), the court of appeals was plainly correct in holding that petitioners were not "contractors" and that the government was not suing on such a contract. As the court of appeals observed (Pet. App. 9a), no executive agency of the United States ever "entered into" an "express or implied contract" with petitioners. Petitioners' only agreement was with Morton, and the government was merely a "third-party beneficiary, not * * * a party" to that agreement (*ibid.*). The CDA defines "contractor" to mean "a party to a Government contract other than the Government" (41 U.S.C. 601(4)). Petitioners plainly were not "part[ies] to a Government contract."

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[4] 28 U.S.C. 1345 provides:

> Except as otherwise provided by Act of Congress, the district courts shall have original jurisdiction of all civil actions, suits or proceedings commenced by the United States, or by any agency or officer thereof expressly authorized to sue by Act of Congress.

The legislative history of the CDA confirms the court of appeals' conclusion (Pet. App. 10a) that the Act was not passed with sureties in mind. Congress intended the CDA to establish a fair and comprehensive remedial system "in resolving Government contract claims." S. Rep. 95-1118, 95th Cong., 2d Sess. 1 (1978). Nothing in the committee reports suggests that Congress wished to extend the procedures of the CDA to claims against sureties. Indeed, sureties were not even mentioned in the reports. See S. Rep. 95-1118, *supra*; H.R. Rep. 95-1556, 95th Cong., 2d Sess. (1978). See also *Universal Surety Co.* v. *United States*, 10 Cl. Ct. 794, 800 (1986).

Petitioners contend, however, that they should be treated as contractors under the CDA because their "liability is strictly derivative" of that of their principal (Pet. 13). But apart from the fact that the CDA does not give the Claims Court jurisdiction over government suits against contractors either, petitioners' contention confuses the question of substantive liability with the issue of jurisdiction. Although a surety's ultimate liability depends upon the liability of the contractor, the government's case against a surety stems from the surety's independent failure to perform under the bond. *Royal Indemnity Co.* v. *United States*, 313 U.S. 289, 293 (1941). There is nothing in the CDA that deprives the district courts of jurisdiction over a surety's independent failure to perform. Petitioners suggest (*e.g.*, at Pet. 8-9, 14-17) that it would be more efficient or fairer to require the government to proceed in the Claims Court, but that policy argument, whatever its validity, cannot alter the fact that Congress has conferred jurisdiction over suits by the government on the district courts under Section 1345 and not on the Claims Court under the CDA.

Petitioners suggest (Pet. 11-14) that the decision in this case is in conflict with decisions of this Court and with those of other circuits. In fact, however, the only other case to consider the argument raised by petitioners likewise held that sureties are not contractors under the CDA. *Universal Surety Co.* v. *United States*, 10 Cl. Ct. 794 (1986). In that case, the Claims Court reviewed the language and history of the CDA and concluded (10 Cl. Ct. at 800) that the plaintiff surety was "not a party to the construction contract" with the government and accordingly was "not a 'contractor' under CDA."

It is therefore respectfully submitted that the petition for a writ of certiorari should be denied.

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